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THE FIGHT FOR FINANCIAL SUPREMACY

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THE FIGHT FOR FINANCIAL SUPREMACY

BY

PAUL EINZIG

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PREFACE TO THE THIRD EDITION

SINCE the publication of this book, the world crisis which has compelled Great Britain to suspend the gold standard has temporarily paralysed London's activities as the world's banking centre. Thus the question which this book tries to answer is no longer "Will London retain her supremacy as the world's banking centre?" but "Will London regain her supremacy as the world's banking centre?" The answer is most emphatically in the affirmative. While six months ago many people hoped or feared, whichever was the case, that the effect of the crisis upon sterling had permanently disqualified London from leadership in the sphere of international finance, to-day there is hardly anyone who can doubt that her return to her old position is merely a question of time. In fact, she has already made good progress in the right direction since the beginning of 1932, and the achievement of the end is perhaps nearer than most people would imagine.

As will be seen in the five new chapters which have been added to the book, neither New York nor Paris was able or willing to take London's place as the world's leading banking centre, so that that function may be said to have become vacant the moment London was compelled to relinquish it. While before

the crisis both French and American interests had endeavoured to supplant London, as a result of the experience of the last few months the financial world has come to realise that London is indispensable as the international distributor of credit. Taking a long view, the suspension of the gold standard has proved to be a blessing in disguise from the point of view of London's supremacy, and there is every reason to hope that the struggle for leadership will end in London's complete victory over her rivals.

P. E.

20 Bishopsgate, E.C.2
May, 1932

PREFACE TO THE SECOND EDITION

SINCE this book was written four months ago, we have witnessed some important developments which are calculated to confirm the author's main thesis as to London's superiority as a world banking centre. During November and December, 1930, there was a serious run on American and French banks, of which even some leading banks did not remain altogether unaffected. A number of small and medium-sized banks failed, while the big banks had to take drastic measures to be prepared for any emergency. In Great Britain, on the other hand, there was no indication of any disquietude on the part of the public. Although exchange position, budgetary outlook, economic conditions, and political situation were much worse in Great Britain than in France or the United States, and the Bank of England's gold reserve compared unfavourably with that of the Bank of France or the Federal Reserve banks, the British public trusted its banks implicitly, and there were no withdrawals of deposits noticeable.

The banking difficulties in France and the United States have had important repercussions on the international banking position of both Paris and New York. Anticipating an accentuation of the crisis, French and American banks called in credits ruthlessly from their foreign customers, placing thereby some of them in a

rather embarrassing position. For instance, but for the eleventh-hour intervention of British banking interests, the withdrawal of American credits might have provoked a banking crisis of first-rate magnitude in Brazil. This and similar experiences are not easily forgotten, and it is reasonable to assume that the debtors affected will in future give preference to the centre which, in spite of its depleted external resources, provides the best safeguard for internal stability.

Another important change that has taken place during the last few months is a rapprochement between the British and French authorities. It is true that the conversations between representatives of the two Treasuries held during January and February have failed to result in any definite agreement; but the fact that the Bank of France reduced its Bank Rate to 2 per cent early in January, and that some days later it decided to remove the embargo on gold of standard fineness, seems to indicate a favourable change in the attitude of Paris towards co-operation. Chapter X., dealing with the French gold imports, has been brought up to date, in accordance with this change; apart from this, the book contains no alterations.

Although it would be premature to rejoice about the progress of co-operation, the signs indicating a better spirit ought to be welcomed. It is hoped that, even though the fight for financial supremacy will continue, it will be fought in future with more consideration for general interests than has been shown in the past.

P. E.

20 Bishopsgate, E.C.2
March, 1931

PREFACE

Will London retain her supremacy as the World's banking centre? The present book is an attempt to answer this highly controversial question. To that end, it compares the strong and weak points of the financial markets of London, New York, and Paris, and gives an account of the endeavours of the last two to capture the lead in the field of International Finance. It arrives at the conclusion that, notwithstanding the spectacular progress made by both New York and Paris—thanks to exceptional circumstances—London will be able to hold her own in the long run.

Admittedly, the two rival centres have succeeded in equalling London and even in leaving her behind in more than one respect. The immense wealth accumulated by the United States since 1914 secures her an incontestable advantage over Great Britain, while the position of Paris compares favourably with that of London in respect of her gold reserve and liquid balances abroad. It will be seen, however, that these are not the only factors which count. London has retained the pre-war superiority of her technical organisation, her advantageous geographical position, and the traditions, experience, and international mentality of her banking community. Thanks to these assets, time favours London, for the chances are that

the abnormal advantages secured by her rivals will be gradually levelled down.

The author has endeavoured to examine critically but impartially the causes, methods, consequences, and prospects of the fight for international financial supremacy. In criticising one or another of the rival centres, it is not as if he would contest their right to attempt to supersede London. Although for the United States and France the possession of a leading banking centre is a mere luxury, while for Great Britain, with her peculiar economic structure, it is a necessity, the legitimacy of the ambitions of New York and Paris to assume leadership is beyond question. The author's criticism is not directed against their endeavours to provide better international financial facilities than London; so long as competition is of such nature it is beneficial to all parties, for it compels London to keep pace with their progress. If, however, competition departs from the constructive field it becomes detrimental not only to the centre against which it is directed but to general interests. It jeopardises international monetary stability and tends to delay the restoration of normal financial conditions.

The author's aim in drawing attention to the struggle for supremacy is to emphasise the need for closer co-operation. To ignore the very existence of the fight is an ostrich-like policy. It is desirable that public opinion should realise its disadvantages, and that pressure should be brought to bear to compel co-operation, in the place of competition, between the authorities concerned.

Although the book is concerned with the fight between the three principal centres, the author considered it relevant to add two Appendices dealing with

the position and prospects of the secondary financial centres. Part of the material of these appendices was published in *The Economist*, while part of Chapter X. appeared in the September, 1930, issue of *The Economic Journal*, and parts of various small chapters have been published in *The Financial News* and *The Banker*. The author wishes to thank the Editors of these publications for their permission to reproduce his articles, and his friends in the banking and diplomatic world who supplied him with information. He also owes a debt of gratitude to Mr. Geoffrey Eley for his valuable criticisms and suggestions, and to Mr. L. P. Thompson for his help in the revision of the proofs. Owing to the highly controversial nature of part of the material, it is only fair to emphasise, however, that the author is solely responsible for the opinions expressed in this book.

P. E.

20 Bishopsgate, E.C.2
November, 1930

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PART I

BEFORE THE CRISIS

CHAPTER I

INTRODUCTORY

BEFORE the financial crisis of 1931–32, those who took the Press interviews and after-dinner speeches of statesmen and financiers at their face-value were inclined to believe that the financial authorities of various countries were working in harmony for the common good, and that ideal conditions of peace and goodwill reigned in the domain of international finance. It was impossible to open a newspaper without reading some optimistic remarks about the progress of international financial co-operation, whether through the medium of the Financial Section of the League, or of the alliance of central banks, or of the Bank for International Settlements. And yet the careful observer could not help noticing from time to time indications of conflicting undercurrents beneath the smooth surface. The exchange of compliments and the niceties of financial diplomacy were a screen to conceal the fact that we were in the middle of a silent but determined struggle for international financial supremacy. The authorities and banking interests of the three leading financial centres—London, New York, and Paris—were making a hard fight behind the scenes for this leadership. The conflict manifested itself now and again in the form of a clash at an international conference on some financial

question; or in an apparently inexplicable withdrawal of gold from one or another centre; or in the failure of some international loan negotiation; or in a stormy board meeting of the Bank for International Settlements.

Until the events of 1931 and 1932 dispelled this pleasant but unreal atmosphere of pretence, the man in the street did not realise that the apparently isolated events were part of one persistent struggle between opposing forces, like battles in a prolonged campaign. He was unaware of the immense interests at stake, or of the supreme efforts which were being concentrated on the fight by the parties in this international financial triangle. It was by no means obvious to the uninitiated that leading bankers or banking groups, in their efforts to serve their own interests against their foreign rivals, served at the same time—consciously or unconsciously—the cause of their centre against the rival centres, or that Governments and central banks, in deciding upon their monetary policy, pursued the same end. Few people knew that there had developed since the war a system of financial diplomacy, the importance of which is increasing steadily. There is intense activity behind the closed doors of Treasuries and central banks; each party is anxious to ascertain and forestall the opponents' next move; unknown to the general public, financial battles are won and lost. Indeed, financial diplomacy works with an almost complete absence of publicity; only a few initiates are in a position to follow its work. Until the crisis the Press had done remarkably little to dispel this atmosphere of secrecy that surrounded the fight for financial supremacy. While an international sports event occupied columns in newspapers, highly important financial events,

negotiations, agreements—each one a landmark in the struggle for financial supremacy—passed almost unnoticed.

It is time that public opinion took an intelligent interest in these developments, which play a prominent part in shaping the monetary policy of nations, and which, through their repercussions on political developments, affect the course of History. In these days economic and financial considerations tend more and more to influence sympathies and antipathies in foreign policy. If, as is to be feared, nations cluster once more into political alliances as before the war, considerations of financial interest will play at least as important a part as those of a purely political nature.

From an international point of view, the importance of the financial factor had increased considerably even before the crisis. Before the war the increase of material wealth and of financial resources kept pace with each other. The war destroyed considerable material wealth, while inflation during and after the war has destroyed a much more considerable amount of financial resources. In countries which suffered inflation there is a disparity between real wealth and financial resources which makes them dependent upon foreign assistance, not only for the development of their unexplored wealth, but even for meeting their requirements of working capital. Before the war there was progress towards a more equal distribution of financial resources between the various nations; this process suffered a marked setback as a result of the war. While, in pre-war days, a comparatively moderate discrepancy between the yield of capital in various countries was sufficient to bring about a movement of

funds, after the war a much wider margin was necessary to draw capital across frontiers. There were a hundred would-be borrowers for each lender.

While, before the war, there was no pressing need for a rapid expansion of production, since the war it has become more important and urgent than ever to create additional real wealth. The present apparent over-production—which is merely a temporary lack of equilibrium—does not alter this fact, if we take the long view. The nations have become heavily indebted, and the standard of living of the working classes has increased before the crisis in almost every country.

In industrial countries trade unionism has enforced high wages, and the increased political influence of Socialism has led to an expenditure on social welfare that has been far beyond the means of the impoverished nations. Even in agricultural countries agrarian reforms have raised the standard of living of land labourers. We had become accustomed to spending more than we earn. In this situation there appeared to be two alternative ways of avoiding bankruptcy: either to reduce the standard of living, or to make a proportionate increase in the production of real wealth. The former was politically impossible before the crisis in democratic countries where universal suffrage prevails. The latter was only financially possible in countries which possessed adequate financial resources, or which succeeded in raising funds abroad. There was, therefore, a scramble for funds on the part of countries anxious to develop their resources with the aid of foreign capital.

Thus the restricted supply of capital available for lending abroad was faced by an increased demand,

which placed those who were able to lend in a monopolistic position. There was, indeed, ample scope for every financial centre to display constructive activity. Each of them would occupy itself to the limit of its capacity without encroaching upon its neighbour's territory. And yet, instead of collaborating to arrive at a rational satisfaction of the world's financial requirements and at the same time to advance their identical interests, they competed fiercely one with another.

It is true that, to a certain extent, they have worked together. The successful stabilisation of currencies in a number of countries was largely the result of their co-operation. The leading banking houses of London, New York, and Paris often joined forces to carry out big international transactions. Innumerable new financial links have been forged since the war between the three markets. International banking groups have been formed to participate in the capital of foreign banks, investment trusts, holding companies, and finance companies of every description. Nevertheless, as often as not, the spirit of rivalry prevailed over that of co-operation. This, in itself, is not necessarily evil; so long as it is of a constructive nature it can only meet with approval. Occasionally, however, it went beyond the limits of sound competition and was directly damaging to financial equilibrium.

Before the war London was incontestably the world's financial centre. Since the war, however, both New York and Paris have set to themselves the task of acquiring this much-coveted position. New York's endeavour was the result of the accumulation of surplus resources, which had to be reinvested abroad. In Paris

the desire to attain supremacy was a natural reaction after the humiliating experiences during the years when French currency was at the mercy of international finance.

The period between the Armistice and the stabilisation of the franc was characterised by a duel between the pound and the dollar. American financial circles hoped to replace the pound by the dollar as the principal international means of payment—a perfectly legitimate ambition, fostered by the immense financial strength acquired by the United States during the war. Great Britain was heavily handicapped in this race, but it must be admitted that the United States proved to be a chivalrous opponent. Official circles in Washington and banking circles in New York realised that international monetary stability was more important for the United States than the victory of the dollar over the pound. Thus, far from putting obstacles in the way of Britain's efforts to restore the stability and prestige of sterling, American interests provided most valuable assistance. Though there was a certain amount of rivalry between British and American banks for international loans and acceptances, it did not exceed the limits of healthy competition. The authorities of both countries established close co-operation, which was largely responsible for the success of Great Britain in restoring the gold standard in 1925. There was a lull in the fight for supremacy between London and New York from 1927 to 1929 while the Wall Street boom changed New York from a lending into a borrowing centre. Subsequently, the slump of 1929–1930 has necessitated the concentration of all American resources upon domestic affairs, and the "armistice" has been prolonged. The struggle may be resumed,

however, after conditions have settled down to a normal level.

It was not until 1927 that Paris entered this international contest. After a period of inflation and violent fluctuation of the franc, stability was achieved towards the end of 1926. The remarkable financial recovery that accompanied the *de facto* stabilisation of the franc enabled the French authorities to make themselves felt in the field of international finance in the spring of 1927, when they attracted attention to their restored strength by large gold purchases. Ever since, Paris has been making great efforts to attain financial supremacy. At first the fight did not exceed the proportions of a duel with London for the lead in Europe. As a result of the preoccupation of New York with domestic affairs during the Wall Street boom and the subsequent slump, Paris has attempted the task of competing with both London and New York for world supremacy, and the fight has become three-cornered. She has proved to be a less considerate rival of London than was New York. While showing an occasional willingness to co-operate, she proved, on the whole, to be a hard opponent. Indeed, she has often been criticised as having placed financial supremacy above the aim of that of international monetary stability.

The apparently uncompromising attitude of France is easily understood if we consider that she had to restore her financial stability without external assistance. While support was generously given to Central Europe, it was almost entirely withheld from France when she was fighting her "financial battle of the Marne". In the circumstances, it is not surprising that she should disregard international considerations when they appear

to conflict with her immediate interests. But to explain is not necessarily to excuse. After all, it was not altogether without reason that support was withheld from France during 1922–1926, as will be shown in a later chapter. Nor, from the French standpoint, was the lack of assistance wholly to be regretted. The success of her effort to restore stability has resulted in very substantial moral and material advantages which she would have missed if the franc had been stabilised with external aid. In any case, it was not to her interest to adopt a financial policy that disregards international considerations. Although such a policy has secured temporary advantages, in the long run they could not fail to be outweighed by the benefits obtainable through co-operation.

It was perfectly legitimate for a great nation to endeavour to strengthen her position in the field of international finance. As French savings continued to increase rapidly, and the trade balance (including invisible items) was steadily favourable, it was only natural that Paris should rise to a position of importance as an international financier. But this end would equally well be attained by co-operation. Perhaps her expansion would not have been quite as spectacular, but it would have been achieved without antagonising other interests, and, in the long run, would prove more beneficial.

In the following chapters an attempt is made to give an account of the course of the fight for international financial supremacy. A comparison is made between their pre-war and post-war situations. It will be seen that, notwithstanding the considerable changes that have taken place since 1914 in relative strength, organisation, etc., London resumed after 1925 the lead,

and, in spite of the fact that, owing to the crisis, she had to relinquish it for a time, she has an excellent chance of remaining the world's principal banking centre. New York and Paris will fulfil important functions in the domain of international finance, but are unlikely to capture the lead from London. There is a fair scope for them both to expand without encroaching on London's position. The conclusion is reached that the latter has certain fundamental advantages which will, in the long run, prevail over the superiority of New York's inherent financial strength or of Paris's liquid resources.

CHAPTER II

CONDITIONS OF INTERNATIONAL FINANCIAL SUPREMACY

BEFORE attempting to examine the relative situation of the three leading centres before and after the war, it is necessary to examine the conditions under which a centre can attain international financial supremacy, and the advantages attached to such a position. The comparison of the financial power of two centres is by no means a simple task. While it is easy to measure naval power by a comparison of tonnages, there is no statistical basis for gauging financial strength. Such factors as experience, tradition, reputation, mentality, are absolutely incapable of measurement. Thus it is not surprising to see three centres at the same time claiming to have attained supremacy: one of them on the basis of its unequalled technical equipment; the second on the basis of the magnitude of its capital resources; and the third on account of the magnitude of its liquid external reserves.

The question we have to consider is the relative importance of these assets in determining the present position and future prospects of a financial centre. Evidently the importance of a financial centre is not dependent upon any one single factor, but upon a set of factors which, to a great extent, are interrelated.

There are, first of all, a number of circumstances of a more or less permanent nature which determine in advance whether a centre can ever attempt to attain financial supremacy. It is impossible to imagine a centre remote from countries that matter from a financial point of view ever attempting to take the lead. Possibly, in the course of time, means of communication will improve sufficiently to reduce the importance of distance. But, for the present, remote centres are disqualified from attaining financial supremacy. It goes also without saying that a city cannot rise to financial prominence unless it is, at the same time, a commercial centre of importance. Nor can it attain supremacy unless it is situated in a comparatively large and wealthy country.

In addition to these general considerations, there are a number of special factors which play an important part in deciding how far it is possible to establish a financial centre in a given city. The most important of these are:

(1) Ample capital resources available for lending abroad.
(2) An adequate banking organisation.
(3) Freedom of the financial market.
(4) An investing public willing to acquire and keep foreign securities.
(5) A stable currency.
(6) A good money market.
(7) A good foreign exchange market.

1. Capital resources for lending abroad may either be owned by the lending nation or held in deposit on account of foreign owners. The lender nation's own capital resources, again, may either be part of the per-

manent national wealth or part of the current national income. Again, the borrowed or deposited resources may be either permanent investments by foreigners, or liquid resources temporarily employed in the centre in question.

Almost every nation has a certain proportion of its wealth invested abroad, either because, in the past, it possessed export surpluses, or because its citizens consider it advisable or desirable to keep part of their capital abroad. Thus every nation is, at the same time, a debtor and a creditor. A nation which has a large amount of foreign investments is bound to take an active part in international finance. It has not only to reinvest funds as they are reimbursed by foreign debtors, but also to shift its existing foreign investments as occasion demands. This involves international banking operations which keep its market occupied independently of any fresh business, and thus provide the foundations of an international financial centre.

In addition to its existing foreign investments, a nation may also have current balances available for reinvestment abroad. If a country exports more than it imports (including invisible items and bullion) the balance automatically remains abroad (not necessarily in the countries from which the surpluses arise) in a liquid form. A foreign loan may represent either the reinvestment of capital returned from abroad or the consolidation of these liquid claims into a long-term investment. A steady export surplus is a good basis for the development of an international market. It makes possible a flow of foreign issues, which helps towards the development of the banking centre, and it results in the creation of an external reserve which enables a country to tide over the "seven lean years."

If a period of adverse trade balances becomes too prolonged, the international significance of the financial centre and the financial supremacy of the country is bound to suffer. An adverse trade balance results in a decline in savings and in an adverse trend in the exchanges; these again cause comparatively high money rates and thus tend to discourage foreign borrowing, whether in the shape of loans or credits. In the long run, they bring about a depletion of the reserve represented by foreign investments. It is, therefore, obvious that a favourable trade balance and a substantial reserve for temporary adverse spells are essential conditions of financial supremacy.

An international financial centre, in the real sense of the term, does not confine itself to lending its own resources. The true function of the banker in a community is to borrow money and relend it at a higher rate. The same is the function of an international centre, which plays the part of banker between nations. Thanks to its well-established credit, technical organisation, and investment facilities, it is able to attract funds in spite of the comparatively low yield it offers. The inflow of foreign funds may assume the shape of long-term investment in the country's securities or temporary investment in short-term credits. In theory, only the reinvestment of the former is considered safe; it is anything but sound for a bank to reinvest in long-term loans funds that are subject to withdrawal at short notice. In practice, however, it is safe for a country to reinvest a great part of the short-term funds that are attracted from abroad. Although they may be shifted frequently, a certain amount is always left in the financial centre, and may be regarded as permanent. In any case, if

there are heavy withdrawals an increase of the Bank Rate can bring about a readjustment.

2. Another condition of international financial supremacy is the existence of an adequate banking organisation, well-equipped, both from a technical and a psychological point of view, for the handling of international banking business. The existence of well-established financial houses, with adequate resources and a solid reputation, and in a position to place in advance, with their permanent customers, a great part of the foreign loans they issue, is essential. If the issuing houses of a centre have a permanent set of underwriters of standing, and excellent connections with trust companies, insurance companies, and other big investors, it tends to reduce to a great extent the risk attached to international loan operations and contribute to the stability of the market. If they have a well-established reputation for successful banking, they are anxious to avoid any transaction which may be detrimental to their prestige, and are prepared to support the market even at the price of sacrifices. It is not sufficient to possess the facilities for floating a loan successfully. It is equally important, in the long run, to be able and willing to support the market against temporary adverse tendencies. While it is a mistake to bolster up a security against fundamental adverse factors, it is equally wrong to leave it to the mercy of speculation. Other things being equal, foreign borrowers prefer to deal with a market whose banking organisation provides the surest guarantee of the comparative stability of their loans.

The banking organisation of a financial centre cannot be regarded as adequate from the point of view

of developing an international market unless the banks are willing to work for fractional profits. In international competition, the centre which is able and willing to reduce the commission to the lowest figure will secure the largest turnover. Rate-cutting can be carried, however, too far, to the detriment of all parties concerned.

It is essential that the banks of an international centre should be willing to co-operate with foreign centres, so as to spread risks and to undertake transactions whose size is beyond the capacity of one single market. They should be willing to take reasonable risks, without being, of course, too speculative. Over-cautious banks, shirking risk and pioneer work, are likely to be left behind by their more enterprising rivals. It is essential that banks should be willing to make prompt decisions, and should possess executive officials with initiative who have authority to conclude transactions on their own responsibility.

3. A financial centre aiming at international supremacy should not have any restrictions whatsoever imposed upon banking activity. Thus, it should grant free entry to foreign banks that are anxious to establish branches or subsidiaries. It must not enforce exchange restrictions, or place any other obstacles in the way of the migration of capital. It should have a free gold market, in theory and in fact. It should have a free market for international loans—though in this respect a certain official control is permissible and even desirable. The absence of legal restrictions, in itself, is not sufficient. Unofficial discouragement on the part of the authorities can prove as effective a handicap to international business as legal restrictions. The hostile attitude of local banks, or of the Press, or of public

opinion, is also detrimental to the freedom of the market, and tends to handicap its international expansion.

Only a market with a thoroughly and sincerely international mentality can rise to permanent prominence as a world centre. Foreign bank branches should be welcomed, as, in the long run, they tend to increase the activity of the market, and attract additional business from abroad. They should not be handicapped by any hostile or ultra-nationalist legislation, such as, for instance, discriminating taxation; or by the unfriendly attitude of local banks, who may make their situation impossible by boycotting them; or by any hostile Press campaigns, which are bound to affect any company whose prosperity depends upon its friendly relations with a wide circle of customers. They must, of course, inevitably be excluded from certain privileges, such as membership of the clearing-house or rediscount facilities with the central bank. Otherwise it is a mistake to restrict the kind of business they may undertake. Though, to some extent, they may compete with the local banks, they are aware of the importance of remaining on friendly terms with them, and are not likely to abuse the hospitality extended to them. In any case, the additional business they attract to the market will more than compensate the local banks for any loss of business through their competition.

So long as the influx or efflux of capital, whether in the shape of transfer of balances, or the purchase and sale of securities, or the import and export of gold, is handicapped by legislation, the market cannot claim to be truly international. During and after the war, every country adopted a number of restrictive measures. The

removal of such restrictions is an essential condition to the development of a financial centre. Only in the market for foreign loans is the maintenance of certain restrictions sometimes a necessary evil. Although an embargo on foreign loans should only be applied in cases of extreme emergency, the authorities are entitled to retain, for considerations of public interest, a certain supervision on foreign issuing activities. As the demand for foreign loans is well in excess of the supply available for that purpose, it is essential that the market should be reserved for loans which secure, directly or indirectly, the maximum possible benefit to the lending country. It is a mistake, however, for the authorities to use their power for political ends. Such an attitude is calculated to be detrimental to the international financial position of the market.

4. Even the largest possible volume of resources available for reinvestment abroad, and the best possible banking organisation, are in themselves unable to create an international financial market without the existence of an investing public able and willing to acquire and hold foreign securities. While the banks are in a position to grant short-term credits to their foreign customers, and to place privately a certain amount of long-term securities, they are, in themselves, unable to provide long-term loans on a large scale without the assistance of the general public. A loan is not well placed unless the bulk of it is acquired by thousands of large and small investors with the intention of keeping it until maturity, for the sake of its yield, without regard to fluctuations in its market price.

While the creation of an adequate banking system for dealing with international business is a lengthy

process, it takes even more time to develop an investing public willing to acquire and hold foreign securities. Encouraging experience for generations is necessary to that end. A series of unfavourable experiences may quickly destroy the work of decades, and may make it most difficult to restore confidence.

5. The possession of a stable currency is an important development of an international financial centre. It is essential that the currency should be stabilised both *de jure* and *de facto*, and that the system adopted should be the gold bullion standard. Although the gold exchange standard is sufficient to maintain stability, a centre claiming the lead cannot afford to base the stability of its currency on the stability of one or several other currencies. On the other hand, there is no need, from a point of view of international financial supremacy, to introduce the full gold standard with coins in circulation. Although the convertibility of notes into coins may reinforce internal confidence in the notes in countries where such reinforcement is needed, it does not in any way increase confidence abroad; in fact, it may be interpreted as a sign of inferiority. The argument that gold in circulation is a secondary reserve, upon which the central bank may draw in emergency, is most unconvincing, as experience has shown that it takes some time before the central bank is able to withdraw the coins from circulation.

It is equally superfluous to amass a huge gold reserve, well over the legal requirements. Undoubtedly it is desirable to have a safety margin, so as to be able to resist temporary adverse influences; but the hoarding of a spectacular gold stock is as superfluous as the issue of gold coins. It will be remembered that the

Bank of England's gold reserve before the war was comparatively small, and in spite of this London was universally recognised as the world's financial centre. At the same time, a market claiming to be the world's banking centre cannot afford to work with a too narrow margin.

The amount of gold and foreign assets required for the purpose of securing the stability of a currency depends, to a great extent, upon the elasticity of the currency system, and upon the confidence of the public in the stability of that currency. The latter factor is influenced to some extent by the past record of the country concerned. It would be a mistake, however, to exaggerate the importance of this consideration. Every currency has undergone a depreciation at one time or another of its history. Recent experience has shown that the world attaches much more importance to present position and future prospects than to past records.

6. A financial centre aiming at international supremacy cannot be content with the possession of a good market for foreign long-term loans. It must also be equipped with adequate facilities for short-term investment. Activity in the market for foreign loans is bound to be of a sporadic nature. It does not, in itself, secure a steady inflow and outflow of funds, which is necessary to keep the market alive, nor does it provide a sufficiently steady source of profits for the financial houses specialising in international banking. An international centre should possess a good discount market as well as a good market for call money or short loans. The existence of adequate facilities for short-term investment is likely to attract considerable funds from abroad, which are available for reinvestment. Foreign

borrowers of long-term loans avail themselves of the facilities thus provided, by leaving in the lending centre the unspent balances of their loans. A good discount market or short loan market attracts substantial funds from abroad, which are available for reinvestment abroad.

While the existence of resources available for lending abroad tends to lead to the development of a market for long-term loans, it does not necessarily lead to the development of a discount market. The latter requires much more experience and technical skill, and its existence depends to a greater extent upon the habits and the mentality of bankers than the former.

7. An active foreign exchange market is also essential to an international financial centre. Foreign exchange markets and discount markets are complementary to each other, for an active discount market, which attracts foreign funds, increases the activity of the foreign exchange market; while a good foreign exchange market, enabling the transfer of funds and the covering of exchange risks at minimum costs, tends to encourage the use of the discount market and the money market by foreign investors of short-term funds. The conditions of a good foreign exchange market are the following:

(1) The largest possible number of foreign exchanges—both spot and forward—should be actively dealt in.
(2) It should possess good cable, telephone, and mail connections with foreign centres.
(3) It should have banks with experienced dealers possessing a great extent of freedom of action, authorised to carry positions and to transact large amounts.

There are several advantages attached to being a leading international financial centre. In addition to the direct profits of the banks engaged in international banking operations, there is the possibility of an increased export trade as a result of lending abroad. The country should also benefit from the acquisition of the control of foreign resources and enterprises, and from the international prestige that attaches to financial leadership. Last, but not least, the political influence that such a position carries is of undoubted value.

The primary motive that induces banks to endeavour to acquire or maintain the supremacy of their centre is the direct profit to be obtained through international banking operations. This may constitute an important item among the invisible exports of a country. Apart from the yield of commission on acceptance credits and on loan operations, the banks and the country benefit by the difference between the rate they pay to foreign depositors and the rate they charge to foreign borrowers. For, as we pointed out above, in addition to lending its own resources, an international financial centre has the advantage of attracting foreign funds. It happens sometimes that it relends to the same country the amounts deposited or invested there by that country.

In itself, the direct profit obtained from international banking activity would hardly justify attaching a very great importance to it. It represents a comparatively small fraction of a nation's income. This fact is often used as an argument against any measure which appears to favour the banking community to the apparent detriment of industries—such as the restoration of the gold standard. It is often said that it is a mistake

to jeopardise industrial interests for the sake of a few hundreds of brokers and bankers. Those who use this argument overlook the deeper significance of the possession of an international financial centre. In the first place, it leads to an increased export trade. We do not share the popular superstition that lending abroad must necessarily result in a corresponding increase of exports by some mysterious process which is never adequately explained by those who use this argument. The claim that the proceeds of a loan cannot be transferred otherwise than in the shape of goods can be answered by reminding that overlending leads to a depreciation of the exchange of the lender country, which again results in an efflux of gold; thus, the proceeds of loans beyond the resources of lenders may leave the country in the shape of gold. At the same time, it is undeniable that trade follows, to some extent, the trend of finance. In many cases, it is made a condition of the granting of a loan that the proceeds be spent in the lending country. In other cases, loans are only granted to borrowers who are known to have the intention of spending a great part of its proceeds in the lending country. In some cases, the would-be exporters or public works contractors help the would-be purchaser to raise a loan in their market. The influence obtained by the lending group in the borrowing country is also often used to induce the borrower to place orders in the lending country. Lastly, the increase of the purchasing power of the borrowing country may directly or indirectly benefit the trade of the lending country.

The international banking activity of a community can also benefit the trade of that community by enabling it to acquire control of foreign enterprise. The acquisi-

tion of railways and public utility enterprises by British capital in Latin America was largely due to the international financial position of London, while their partial transfer to American hands during the last few years was largely the consequence of New York's increasing importance as a financial centre. The possession of the control over such enterprises naturally tends to influence the direction of orders.

The supremacy of an international financial centre lends the country considerable prestige abroad. This prestige tends to influence trade, and is otherwise also beneficial to those in contact with foreign business interests. International financial syndicates cannot be considered complete unless that centre is represented in them, and its representatives usually lead the group. It is difficult to imagine international banking groups engaged in important transactions under the leadership of a bank with its headquarters in a secondary centre.

As a result of the prestige and economic influence of an international financial centre, financial supremacy has also considerable political advantages. Financially backward countries are desirous of becoming the political satellites of one or other of the leading financial countries, so as to be assured as to their requirements of financial support. In political combinations, financial strength plays, nowadays, almost as important a part as military strength. If the voice of the United States carries weight in world politics, it is not so much on account of the size of its Navy, or the potential size of its Army, as of its great financial power. In international conferences, the word of a financially strong country carries more weight than that of a much larger, but financially weaker, country. It is often

possible to obtain political advantages by means of financial transactions. A lending country usually acquires a certain amount of political influence in a borrowing country, not so much on account of past loans as owing to the anticipation of future loans.

Thus, financial supremacy is desirable, not only for its own sake, but also for the sake of its indirect advantages. In the case of Great Britain and the United States, the attraction is mainly the economic advantages involved, though political advantages are not disdained. In the case of France, financial supremacy is rather a means to political supremacy—though economic advantages are also duly appreciated. The divergence in outlook is explained by the fundamental difference between the Anglo-Saxon and Latin mentality.

The importance of financial supremacy for a country depends upon its economic structure. For countries that are largely self-supporting, it is merely a luxury. For countries which are far from self-supporting it is a necessity. Hence the determination with which Great Britain concentrated her efforts from 1920–1925 on recovering the lead in the field of international finance, and with which she seeks to hold this position against the competition of other countries.

CHAPTER III

LONDON'S LEAD BEFORE THE WAR

WE have seen in the previous chapter the conditions under which a financial centre may attain international supremacy. Our next step is to examine how far these conditions existed before the war in London and in its rival centres.

Until the war, London's position as the world's financial centre was beyond question. All other financial centres—Paris, Brussels, Amsterdam, Berlin, Zurich, and New York—were incomparably inferior, and were not considered seriously as London's rivals. Paris was fairly active as a market for international loans, but her significance as an international money market was comparatively small. She had no discount market, and, though officially on a gold basis, had no free gold market owing to the traditional reluctance of the Bank of France to part with gold. Brussels was an active financial centre, and the part it played in international finance was out of proportion to the relative importance of Belgium. The same may be said of Amsterdam. In both these centres, as well as in Paris, money rates were usually lower than in London. In spite of this, they did not develop as international markets. London usually acted as intermediary between these markets on the one hand, and New York and Berlin on the other, as in the latter centres money

rates were, as a rule, higher than in London. Switzerland, like Amsterdam, owes the development of its international finance market to war and post-war conditions. Before the war, the importance of both these markets was comparatively small. As for Berlin, during the last pre-war decade, it rose to some importance as a capital market, especially for Central Europe and the Near East, but as a money market it was in some ways second even to Frankfort-on-Main, and played a subordinate part in international relations. The New York financial market, though it was reaching the stage when it began lending as well as borrowing, was comparatively primitive.

The undoubted pre-eminence of London in the domain of international finance was due to the following circumstances:

(1) Great Britain possessed immense resources in the shape of external investments representing the accumulation of favourable trade balances during many decades. The amount of British capital invested abroad before the war was estimated at about £4 milliards. These investments were being constantly turned over, and the redeemed amounts were being reinvested abroad. Even if British external resources had been stationary, their administration would have, in itself, kept London's financial market moderately busy. But the external resources were far from stationary. There was, almost every year, a surplus of visible and invisible exports over visible and invisible imports, which was invested abroad. The exchanges tended to be mostly in favour of sterling, which, together with the control of the South African gold supply, made it possible to maintain a low Bank Rate and to grant loans on comparatively favourable terms.

Apart from its permanent external investments and current export surplus, London had also the task of reinvesting considerable amounts lent by foreign capitalists to this country. British Government bonds and other securities were always regarded as a favourite investment abroad. Great Britain was considered the safest country to invest in, and capitalists in countries where political conditions were not altogether stable made it a rule to keep part of their wealth in London. There were also large amounts of temporary foreign balances held in London, though perhaps not on the same scale as after the war. The London discount market, about which more will be said below, attracted considerable foreign funds seeking temporary investment.

In addition, the comparatively large volume of the foreign trade of Great Britain provided the international banks established in London with a fair amount of business. Being probably the least self-sufficient country with a high standard of living, Great Britain's imports were always very heavy. She had also an active transit trade which was financed in the London market.

(2) A second condition of financial supremacy is the existence of an adequate banking organisation. In this respect London occupied a unique position before the war. She possessed a large number of old-established banking houses, with traditions of international banking, a sound experience extending in some cases over two centuries, and a highly valuable goodwill, represented by their first-class reputation all over the world. As London had a larger banking turnover than any other financial centre, its banks could afford to work on a basis of a narrow margin of profit. As its

banking houses specialised in various branches of activity, and as they had old-established connections with reliable foreign houses, the risk attached to their work was relatively slight. The superiority of the technical equipment of London as a banking centre before the war is too well-known to require repetition. In addition, the London bankers possessed something which cannot be expressed in figures, but which is more important than any of the concrete factors, and that is the right mentality required for international banking. Although far from being speculative, they were prompted by a keen pioneer spirit and were anxious to break new ground. Before the war, no country possessed such an extended network of bank branches and subsidiaries in foreign countries as Great Britain. The merchant banks had customers even in the remotest countries. Thanks to their experience and good sources of information, they were able to select their customers among the best commercial houses of a country, so that the risk attached to dealing with countries where conditions were far from stable was more apparent than real.

Moreover, the London banker always possessed a faculty for quick decision, and allowed wide scope to the initiative of his senior officials, which largely facilitated business in the domain of international banking.

(3) A free international market is another condition essential to international supremacy. In this respect, London easily held the lead before the war. Her financial market has always been characterised by an essentially liberal spirit, which may be due, to some extent, to the British tradition of Free Trade. This spirit of freedom manifested itself, in the first place, in the hospitality with which branches of foreign

banks were welcomed in London. There were no legal restrictions on their establishment, and no direct or indirect compulsion was brought to bear on them to induce them to register themselves under British law. They also had complete freedom in selecting their personnel, and they enjoyed an equal treatment as to taxation. They were at liberty to transact business of every description. In fact, they held a very strong position in the foreign exchange market; they granted acceptance credits; they participated occasionally in the issue of loans; they were very active in arbitrage of every kind, especially bullion arbitrage. There was nothing in law to prevent them from accepting deposits—a branch of activity reserved in many countries for banks of their own nationality.

The only differentiation against foreign branches was that they were not admitted for membership in the Clearing House. But in this respect Colonial Banks, Exchange Banks, and merchant banking houses were in a similar position, so that it could not be regarded as a measure specially devised to handicap foreign branches. Another point in which they were in a less favourable position than British banks was that they did not enjoy rediscount facilities, and their acceptances could not be discounted with the Bank of England. Apart from that, there was no handicap to their activity, either in law or in practice. Although they were, to some extent, competitors of British banks, the latter did not regard them as intruders. They fully realised the extent to which foreign bank branches contributed to the development of London as an international centre.

There was also complete freedom for the employment of foreign subjects in British banks, and for the

establishment of private banks by foreigners. Although in some quarters this freedom is criticised from a political point of view, it has certainly contributed to the development of a thoroughly international spirit in the London market, and has given London several prominent banking families.

As regards dealings in exchanges and the international transfer of funds, there were no restrictions whatsoever in London before the war. In this respect, however, most centres were in an equally favourable position, for exchange restriction is a war-time and post-war invention. Where London was superior to some of her rivals, especially Paris, was in the essentially non-political character of the lending policy of her financial market. While in Paris the authorities often took a hand in preventing certain loans and in encouraging others, for considerations of a political nature, in London the principle of *laissez-faire* with regard to the issue of foreign loans was never questioned. An occasional hint was given by the authorities, but it was not stressed sufficiently to interfere with freedom of action.

The point in respect of which London was incomparably superior to any other centre was in the absolute freedom of her gold market. The Bank of England followed a policy of strict neutrality towards gold movements, and did not, in any way, interfere with the free working of the gold standard. It was in a position to pursue a liberal policy because of the huge external reserves of the country and the steady supply of South African gold which came to the London market, and upon which the Bank had first call. While in other countries the export of gold was very often hindered, and the import of gold was very often stimu-

lated, in London, gold movements were allowed to take care of themselves. The only way in which the Bank of England influenced them was through the normal manipulation of its rediscount rate.

(4) Another condition to which London owed her pre-war supremacy was the existence of a large and wealthy class of investors who were willing to take up and hold foreign securities. Having been accustomed to invest in the Colonies, British investors found it comparatively easy to acquire a taste for investment in foreign countries. Pre-war experience encouraged them to do so, for the amount of losses suffered from foreign investments was, on the whole, small. Thanks to the conservative policy of discrimination of the well-established London issuing houses, the class of securities placed in this country was generally good, and the risk was not, therefore, unreasonable.

Moreover, London had the great advantage of possessing a unique class of investors—the investment trusts, which, before the war, were an exclusively British institution. The large resources they controlled, and their highly intelligent management, had made them into a very important factor in the financial market. In addition, London being the principal insurance centre of the world, had a number of big insurance companies with huge reserves to invest.

(5) A stable currency which is above suspicion is one of the most important conditions of financial supremacy. In this respect, too, London was at an advantage as compared with her pre-war rivals. Sterling had a longer tradition of stability than any other currency. It was regarded as absolutely safe in every part of the world, and was considered as the stable international means of payment *par excellence* not only in

civilised countries, but even in primitive countries. Such was the confidence in sterling that British banking houses, when granting long-term loans to foreign borrowers, never considered it necessary to insert in the contracts the so-called "gold clause", meaning that the loan was repayable in terms of sterling and not in terms of gold. This was because the pound was always considered as being synonymous with a fixed quantity of fine gold.

It is necessary to emphasise that this confidence in the stability of sterling was not acquired by means of possessing a huge gold reserve. The Bank of England's metallic stock was small in relation to the immense volume of international banking business transacted in London. It was smaller than the reserve of the Bank of France, and the amount of gold coin in circulation was also smaller than that of France. Confidence in sterling was inspired by the British traditions of integrity in finance, and by the existence of a large "secondary reserve" in the shape of foreign securities and short-term claims.

(6) The possession of a good money market, in the broader sense of the term (including a market for call money, short-term loans, and a discount market), is also one of the essential conditions of supremacy. In this respect, London's superiority before the war is a matter of common knowledge. Thanks to the existence of well-established discount houses and bill brokers, the London market provided unequalled facilities for short-term borrowing and lending. Its bill market was unique. No other centre even attempted to compete with the London market, and the sterling bill was regarded as a universal means of payment in international trade.

The large turnover of the bill market and the narrow margin between buying and selling rates provided a guarantee to both buyers and sellers of bills that they would be able to obtain a fair rate. The freedom of the gold market provided a guarantee as to the withdrawal of their funds from London.

(7) An international centre has also to possess a good foreign exchange market. In this respect, pre-war London left much to be desired. The number of foreign currencies quoted was comparatively small, and the houses actively engaged in foreign exchange business were few. In this respect, London did not take full advantage of her favourable position, and there was ample scope for future expansion. Her geographical position, her excellent mail connections, the large volume of her foreign trade, and her foreign banking activities, contained the elements of the development of her foreign exchange market, which was, however, handicapped by the extensive use of sterling as an international means of payment. This was, of course, an advantage from the point of view of London's international importance, but tended to reduce the activity of her exchange market.

Let us now examine the conditions of pre-war Paris. She was undoubtedly second in importance to London, but lagged far behind London and did not make any serious effort to develop into a dangerous rival.

(1) Although France possessed large capital resources, and was the second largest foreign investor before the war, her foreign investments were much smaller than those of Great Britain. Her export surplus was also inferior, and so was the volume of her foreign trade. Being a self-supporting country to a much greater extent than Great Britain, France did not require nearly

as much banking activity in connection with her foreign trade, including transit trade, as Great Britain. The amount of foreign funds invested in France and available for reinvestment was also smaller than in Great Britain. French securities were quoted in some foreign markets, but were not acquired as investments to any great extent outside France. Paris had no extensive discount market, and her money market did not attract any foreign funds because interest rates were usually low.

(2) Although Paris possessed a number of well-established banks, her banking organisation, from the point of view of international finance, was decidedly inferior to that of London. Owing to the popularity of the habit of hoarding, banking resources were comparatively small. Specialisation was not developed to the same extent as in London. The mentality of the French banker was also unsuitable to development in an international sense. About this more will be said in Chapter VI., dealing with post-war conditions.

(3) The principle of freedom of the financial market was not developed to the same extent as in London, and the French Government did not adopt an attitude of non-interference with banking activity. Although the movement of funds was as free as in London, lending abroad was largely influenced by political considerations. The disadvantages of this influence did not manifest themselves greatly until the war. Where Paris was at a great disadvantage as compared with London was in respect of the freedom of the latter's gold market. The Bank of France pursued a policy of gold accumulation, and to that end it was liable at any time to make use of its right to pay out silver instead of gold, and to encourage gold imports

by the payment of a premium over and above the legal buying price.

(4) As to the investing public, Paris was in a very favourable position. Thanks to the thrifty habits of the French middle classes and rural population, there were large resources always awaiting investment. French *rentiers* were willing to acquire foreign securities and provided good material for the issuing activities of French banking houses. It was probably the lack of a sense of discrimination amongst this class of small investor that encouraged the issue of types of foreign securities which, already before the war, led to unfavourable experiences and which resulted in huge losses to the French investing public after the war.

(5) The French franc enjoyed a high degree of confidence before the war. The fact that the Franco-Prussian War of 1870–1871 did not bring about any spectacular depreciation of the currency tended to increase this confidence. The connection of the franc with other currencies, through the Latin Monetary Union, was also a factor of some importance. At the same time, it is impossible to overlook the fact that in France confidence in the franc was not as strong as confidence in sterling was in Great Britain and in foreign countries. Thus the majority of foreign loans issued in France were issued in terms of "gold francs", and this suggested that French banks had no absolute certainty that the franc would always mean gold. But this qualification of the confidence in the franc was not sufficiently pronounced to interfere with the international position of Paris.

(6) The Paris money market was fairly active and was essentially a lending market owing to the low rate

of interest prevailing there. On the other hand, a discount market was non-existent, from an international point of view.

(7) The Paris foreign exchange market was perhaps more active than London, especially as far as dealings in Continental currencies were concerned.

Let us now turn to New York. Before the war that centre was too occupied in financing the interior economic expansion of the United States to pay much attention to the development of an international market. Further, until a few years before 1914, the United States was one of the principal borrowers in London and in other European markets. Although she had been participating to some extent in the issue of foreign loans, she did not claim to be a rival to London.

(1) Prior to 1914, the capital resources of the United States available for lending abroad were comparatively very small, and the willingness to lend abroad was slight. After all, there was a great deal to do at home, and all the available resources were required for domestic purposes.

(2) The banking organisation of New York was built essentially for financing domestic trade. As the demand for domestic financing was much in excess of the supply of facilities, it was not the ambition of the New York banks to develop their international activities to any great extent. They had absolutely no tradition of international banking, and the mentality of the average New York banker was anything but international.

(3) In the circumstances, there was little advantage in the freedom of the international market of New York, which in any case compared unfavourably with the freedom of London.

(4) As to the willingness of the American investing public to acquire foreign securities in pre-war days, it was practically non-existent. Most people possessing capital were financing their own business with all their available resources, and if they acquired any securities these were usually American stocks with a promise of capital appreciation.

(5) The dollar did not play a substantial part as an international means of payment. As the banking system, prior to the adoption of the present Federal Reserve System, was inadequate and subject to periodical crises, confidence in the stability of the dollar in foreign countries was not altogether strong enough for the requirements of an international centre.

(6) The New York money market was a persistently borrowing market, and, as such, played no active part in international finance.

(7) As for the foreign exchange market it was comparatively undeveloped, even for pre-war days.

It is thus obvious that, before the war, both Paris and New York were much inferior to London as international financial centres. The difference was very marked, especially in the case of New York. In normal circumstances it would have taken several decades before either of them could have developed to a sufficient extent to threaten London's supremacy. Owing to the abnormal war and post-war conditions, however, they underwent an unexpectedly rapid development, which will be dealt with in later chapters.

CHAPTER IV

LONDON AFTER THE WAR

WAR and post-war conditions have radically changed the international financial position of London. Although in most respects they have affected it adversely, from certain points of view the international financial market of London has benefited by the change. The scope of this chapter is to compare the pre-war position with the conditions that prevailed after the war until the outbreak of the financial crisis of 1931.

(1) The amount of British capital resources invested abroad underwent a considerable decline during the war. The American securities, which were a substantial item on the list of British holdings of foreign securities, were called in by the Government, and used for the support of sterling in the United States. Other blocks of securities found their way to the United States by sales in the open market or by agreements between British and American interests. This was recently the case with regard to British holdings of public utility enterprises in South America. The existence of British Government indebtedness to the United States Government has scarcely reduced the net amount of British investments abroad, as it is balanced by British claims against Germany and against the Allied countries.

The amount of foreign funds invested in Great Britain was higher than it was before the war. The adoption of the gold exchange standard in many countries has resulted in the acquisition of sterling balances by a number of foreign central banks. Considerable amounts of British gilt-edged and other securities have been acquired on American and other foreign account. The London discount market provided as strong an attraction for foreign funds seeking temporary investment as at any time in the past.

The volume of British foreign trade was larger than before the war, and required a large amount of financing. The trade balance (including invisible items) still continued to show a surplus of exports over imports amounting to about £150 millions per annum, and the reinvestment of that amount provided London's banks with some international banking activity.

(2) The banking facilities of the international financial market of London have greatly improved since pre-war days. The amalgamation of commercial banks has resulted in the creation of banking units of unprecedented magnitude, with immense resources. While, before the war, clearing banks were not particularly active in the domain of foreign banking, at present they devote a considerable part of their attention and their resources to foreign business. Although it is open to argument whether this development is desirable from the point of view of financing home trade, we are concerned here with the international position of London, and from that point of view the change was certainly to the good. The capacity of London for dealing with foreign business has, indeed, increased to no slight extent. In addition to the banking houses which specialised in foreign business

before the war, there are now the foreign departments of the Joint-Stock Banks. The war did not affect in any way unfavourably the international spirit of the London banking community. It has not forgotten anything of its pre-war knowledge, and has gained additional experience, while its technical equipment has decidedly improved.

(3) As a result of the war, the spirit of *laissez-faire* could not help, to a certain extent, losing ground. During the war the property of German banks established in London was sequestrated and their branches were closed, and for some years after the war there were restrictions against their reopening. These restrictions, however, have been removed, and at present the market is as free for the establishment of foreign banks as ever before.

Whatever may be the notions of bankers about Free Trade and Protection, they are almost unanimously liberal, as far as the freedom of the international market of London is concerned. There is no hostility towards any foreign bank established in London, and the post-war period witnessed the establishment of a number of new foreign branches. On the other hand, the German branches, which were closed during the war, have not been reopened, but this has not tended to reduce the volume of international business transacted in London, for the German banks which had branches here in pre-war days work to a great extent through English banks and financial houses.

Great Britain was one of the first countries to remove every kind of restriction on exchange operations and on the international transfer of capital. At present, the situation in this respect is exactly the same as it was before the war. Admittedly, there is still

an unofficial embargo on foreign loans which is detrimental to the freedom of the market. This, however, does not place London at a disadvantage as regards other centres, for in both France and the United States the issue of foreign loans requires the consent of the authorities, which amounts to the same thing as the unofficial embargo in London. Nevertheless, it is desirable to do away with this restriction as soon as circumstances permit, for its existence is detrimental, both from a point of view of prestige as well as from a point of view of practical business. If her rival centres precede London in this respect, it would weaken her international position.

The freedom of gold movements was restored in 1925 and has been maintained, both in law and practice, until 1931. In spite of the comparatively narrow margin of its gold stock, the Bank of England has pursued a policy of non-interference with gold movements. The South African gold supply has provided an independent source for those wanting to withdraw gold from London: although there has been a certain amount of Press criticism against withdrawals from the Bank, this should not be interpreted as being detrimental to the freedom of the gold market. These criticisms were directed against the hoarding of gold by certain central banks, and were inspired by considerations of international interest rather than by questions of the convenience of the London market. Moreover, even in New York, gold movements of this kind met with similar criticisms, in spite of the superiority of the American gold reserves.

(4) The British investing public suffered considerable losses on its foreign investments during and after the war. Holders of Russian securities lost their capital

completely, while the holders of Turkish, Bulgarian, Austrian, etc., securities had to consent to considerable reductions in value. Inflation in several countries, especially in Germany and France, has also caused substantial losses to British investors. In spite of these losses, however, the willingness of the British public to acquire foreign securities has not diminished to any great extent. Although, for the moment, there is no demand for foreign securities, this is due to temporary world-wide causes, and not to causes peculiar to the London market.

With its large number of investment trusts and insurance companies, which have increased their resources since pre-war days and are willing to acquire foreign securities, the London market continues to have a good background for its international issuing activities.

(5) As to the stability of sterling, pre-war conditions were fully restored between 1925 and 1931. Although during and immediately after the war sterling underwent a fairly considerable depreciation, the decline of its value was much less pronounced than that of the currencies of any other European participant in the war. The range of its fluctuations between 1919 and 1925 was much narrower than that of any other European currency, with the exception of the Swedish, Swiss, and Dutch exchanges. Between 1925, when the gold standard was restored, and 1931, when we were forced off the gold standard, the movements of sterling were limited by the gold points. Although the gold points were somewhat wider than before the war, and were liable to much more frequent and pronounced changes than in pre-war days, this factor affected every currency, including the dollar. In any case, the range

of possible movements was, for most exchanges, rather less than one per cent, which could hardly be considered abnormal. After the restoration of the gold standard, sterling had undergone some rather severe tests. In 1926 there was the General Strike and the Coal Strike, while in 1929 there was exceptional pressure upon the exchange on account of the westward movement of funds caused by the Wall Street boom. The pound sterling had, however, stood those tests, and until the crisis of 1931, which came like a bolt from the blue, there did not appear to be for a moment any danger of a suspension of the gold standard.

In spite of this, rumours were circulated from time to time on the Continent as to the possibility of a departure of sterling from its gold basis. The fact is that, but for the crisis which upset all human calculation there would have been no question of any departure of Great Britain from the gold standard. Although her gold reserve was not nearly as big as that of the United States or France, she still had, on the other hand, the largest holding of foreign securities, which would be considered as a kind of secondary reserve to the currency; and though they could not be converted into foreign exchanges and mobilised in defence of sterling at short notice, in practice persistent adverse conditions usually result in the selling of part of the British holding of foreign securities to foreign buyers. Nobody had envisaged the possibility of a crisis that would completely immobilise this secondary reserve.

Another reason why a departure from the gold standard appeared to be unlikely was that in practice the gold reserve was no longer considered as security for the internal note circulation and was available to a greater extent than ever before for the purpose of meeting

international requirements. The Bank of England was prepared to allow a considerable decline of the gold reserve if it was brought about by an adverse trend of sterling. Moreover, it was taken for granted that the British monetary authorities could always rely upon support from the American monetary authorities, if necessary, in order to protect sterling against some abnormal adverse factor. It was considered unthinkable that a situation could arise when the American authorities would cease to be able or willing to support sterling if necessary. This fact in itself appeared to place sterling beyond doubt.

As to the prospects of sterling in the long run (meaning thereby a period of several decades), the best answer to any doubts was to point out that, in spite of the great upheaval of 1914–1918, sterling was restored to its pre-war parity at the cost of heavy sacrifice. The confidence of British banks and the British investors in sterling is duly illustrated by the fact that, notwithstanding the experience of the war, foreign loans issued in London continued to be expressed in terms of pound sterling and not in terms of "gold pound". While in France, every new loan was expressed in terms of gold francs, and in the United States, foreign loans were expressed in terms of dollars "representing the present weight and fineness of gold" of that currency, in Great Britain it was considered superfluous to add the word "gold" to sterling. This was the pre-war practice, and this has remained the uninterrupted practice since 1914.

(6) The facilities of the London money market and discount market were until 1931 at least as good as, if not better than, in pre-war days. Although sterling did not enjoy any longer the monopoly it enjoyed

before the war, it was none the less the chief international means of payment. The competition of New York, Paris, and other centres has not diminished the volume of business in the discount market, and short-term Treasury bills have become as popular a form of investment as fine bank bills. Possibly discount rates were more sensitive to international influences than before the war, but this again was by no means peculiar to the London market; it was a world-wide phenomenon, due to the abnormal international movements of funds.

The activity of the money market, from an international point of view, has increased as compared with pre-war days, and a considerable market has developed in short-term loans or deposits, expressed in terms of foreign currencies. It was possible to lend or borrow in London in terms of dollars or Reichsmarks with the same facility as in terms of sterling.

(7) In the foreign exchange market developments since the war have been decidedly favourable. A comparison of the table of foreign exchange quotations published in the daily Press with a pre-war table is sufficient to indicate the extent to which the market has expanded. The number of quotations is several times as great as in pre-war days. Almost every currency in the world is quoted in London. Moreover, an active market has developed in the forward quotations of the principal exchanges. It is an opinion shared by most impartial foreign experts that the London foreign exchange market is the largest and best in the world. Even the crisis has made no material difference in this respect, while before 1931 London's superiority as a foreign exchange market was uncontested. In Europe, it is practically the only market

which deals regularly in South American and eastern currencies, and it has the monopoly of British Dominion currencies. It is the best market in Europe for dollars and a number of European currencies. Although its activity in some of the eastern and south-eastern European currencies is inferior to that of Paris or Zurich, the total volume of foreign exchange activity is probably higher than in any other market. This is largely due to the fact that dealers in London are allowed a comparatively free hand to carry positions. While most banks in Paris or other Continental centres would not quote firm dealing rates for considerable amounts, in London it is possible to obtain firm rates even for amounts of several million dollars. For this reason, if a Swiss bank, for instance, wishes to buy dollars, it approaches London in the first place, in spite of the proximity of Paris or Berlin.

We have seen above that, notwithstanding the changes brought about by the war, London was, until the financial crisis of 1931, undoubtedly in possession of the facilities to which she owed her financial supremacy in pre-war days. If her supremacy was no longer uncontested, this was not due to any decline of the London market, but to the more rapid progress of the two rival centres. In international loan operations of any considerable size it was difficult to form a financial group without the participation of London banks. London was still the Mecca of all would-be borrowers, whether they required long-term loans or short-term credits. The monetary policy of the Bank of England was still of decisive importance in shaping the monetary policy of other countries. To give only one example, it was the restoration of the gold standard in Great Britain that induced practically all advanced

countries to return to a gold basis. There is no doubt that had the British authorities chosen to adopt a managed currency their lead would have been followed by a large number of other countries. The fact that Great Britain did not reintroduce gold coins in circulation was largely responsible for similar decisions by practically all the other central banks. From the point of view of prestige it was not considered derogatory to any country not to possess an active gold coin circulation so long as Great Britain was satisfied with the gold bullion standard without any issue of coins. The Bank Rate decision of the Bank of England was often taken for guidance by a number of Continental banks. Tendencies in the price level in Great Britain greatly affected the tendencies of the world price level. The trend of the London discount market determined discount rates in other markets, while the London foreign exchange market took the initiative in changing tendencies of exchange rates probably more often than any other market.

CHAPTER V

NEW YORK AFTER THE WAR

From a financial market of hardly more than local importance, New York has developed, almost overnight, into an international financial centre of first-rate magnitude. This was the result of the accumulation of wealth in the United States during the war. Apart from having acquired a large part of the American securities issued in Europe before the war, the United States has become the creditor of practically every European nation. A considerable part of the gold stock of European countries was shipped to New York during and after the war. Without having originally any ambitions to develop into an international financial centre, New York has attained that end by the force of circumstances. *L'appétit vient en mangeant.* Once American finance became conscious of its immense power, it endeavoured to make use of it and to increase it. As the result of the fluctuation of European currencies, the dollar became, during and after the war until 1925, practically the only stable currency. As such it was adopted more or less as a universal means of payment in place of sterling. American financial interests have endeavoured to retain this position for the dollar, even after the stabilisation of sterling. To that end, considerable efforts have been made to develop a discount market in New York.

Let us try to determine how far the war has changed the essential factors affecting the international financial position of New York.

(1) The capital resources of the United States invested abroad attained a fantastic figure during and after the war, a considerable part being represented by Allied debts. The annual amount obtained in interest and redemption was a most important item in the balance of payments of the United States. It was largely responsible for the surplus of visible and invisible exports over visible and invisible imports which has been shown almost every year since the beginning of the war. This amount had to be reinvested in some form abroad, and provided New York with a fair volume of international banking activity. Owing to the situation of the trade balance, the United States had to develop as an international centre.

In addition to the formidable resources owned by the United States in the shape of claims on foreign countries, she was also in a position to reinvest the foreign capital that has been imported into the United States. During the boom, American industrial, railway, and public utility shares have become favourite investments all over the world, and, although the United States is a large creditor of the rest of the world, at the same time, other countries have acquired counterclaims in the shape of holdings of American securities. These holdings have been considerably reduced since the Wall Street slump, but are believed still to represent an important figure.

Apart from the foreign capital invested in securities, large amounts of foreign funds were at one time invested in New York in the shape of large deposits or brokers' loans. During the boom, when the rate of

interest paid on brokers' loans attained a fantastic figure, immense amounts of liquid funds were attracted from every country; but since the slump these funds have been withdrawn. On the other hand, the amount of foreign deposits held by American banks remained substantial for some time even during the crisis. The New York discount market does not seem to attract any foreign capital, apart from the dollar-bill holdings of foreign central banks. The authorities did not seem to encourage the investment of foreign short-term funds in New York. In fact, there is a special tax on interest earned by foreign corporations. It is obvious that, notwithstanding this, from the point of view of funds available for investment or reinvestment abroad, New York easily held the lead over London or any other financial centre.

(2) The banking system of New York has adjusted itself to a very great extent to changed requirements. While, before the war, it was equipped mainly for domestic financing, after the war it developed an organisation to deal with international business. As in London, so in New York, the amalgamation of commercial banks has resulted in the creation of huge banking units with immense resources. Although the principal task of these banks remains the financing of home trade, they have also developed foreign departments. The financial houses have also taken up a great deal more foreign business than before the war. It is stating the obvious to point out that the American banker and his staff lack tradition in international banking and experience to deal with international transactions. Such experience cannot be acquired overnight, and must necessarily be a slow development. It is unquestionable, however, that considerable pro-

gress has been made in this direction during the last few years, thanks largely to the immigration of many European bankers. The American banker is at a disadvantage in international competition in the margin of profits he requires. Overhead charges are higher in New York than in any other centre, and banks there are accustomed to substantial profits on domestic banking business. They are reluctant to work for the same narrow margin as their European rivals. This does not mean that it is an easy task to defeat American bankers in a rate-cutting contest. If it comes to that, they are prepared to work without any profit or even at a loss in the field of international business, and to make up for their losses in the field of domestic business.

(3) The freedom of the financial market of New York leaves little to be desired. No obstacles are placed in the way of the establishment of foreign branches, although it is more advantageous to establish subsidiaries registered under American law, in order to be able to transact certain types of business from which foreign branches are excluded. In many cases, foreign banks have both a branch and a subsidiary in New York. The existence of important foreign colonies of various nationalities assists the development of foreign branches, as it provides them with a certain amount of steady business. There is, further, no restriction whatsoever on foreign exchange transactions or transfer of funds. The issue of foreign loans, on the other hand, is subject to the approval of the State Department, which occasionally interferes to no small extent with the freedom of the market. From time to time violent campaigns are launched by politicians and the Press against lending abroad, or to Europe in general, or to one country in

particular. This interferes in practice with the freedom of the loan market, for the investing public of the United States is easily influenced by such propaganda.

The gold market is, of course, entirely free, which is only natural considering the size of the gold reserve. At the same time (as was pointed out in the previous chapter), in cases of heavy gold withdrawals for destinations which are not approved, there is a fair amount of adverse Press criticism.

(4) The principal weakness of the international market of New York lies in the absence of an adequate investing public for foreign loans. During the last seven years or so, bond-selling houses spared no effort to educate the American investor to appreciate the advantages of investing in foreign bonds. Through applying every device of their highly developed art of salesmanship they succeeded, between 1923 and 1928, in placing a formidable amount of foreign bonds of every description with the American public. The experience of the last two years, however, has proved conclusively that it was premature to rejoice over their triumph. As a result of the Wall Street boom, ninety-nine out of a hundred holders of foreign bonds sold out in order to be able to buy shares. The major part of the bonds placed in the country, at the cost of considerable efforts and sacrifices, in the course of four or five years, found its way back to the New York market in the course of a few months. Large amounts were sold back to Europe, as their depreciation made their yield attractive to the European buyer. The bond-selling houses became congested with foreign bonds, which paralysed their activity and prevented them from participating in new issues to any great extent. Thus, notwithstanding the immense amount

available for investment abroad, the international banking activity of New York has rather narrow limits, at any rate as far as the issue of long-term loans is concerned.

The New York market itself is well aware of this shortcoming. Even during the most feverish activity of foreign issues, its financial houses were anxious to create a market for the bonds in other countries. A portion of almost every foreign dollar loan was issued in the smaller Continental financial centres, such as Amsterdam, Switzerland, and Stockholm, while for years great efforts have been made to place dollar bonds privately in Great Britain.

While the lack of experience of American bankers in foreign business will undoubtedly be overcome in the course of time, there is very little hope that the reluctance of American investors to acquire and hold foreign securities can be entirely overcome in the lifetime of this generation.

(5) The stability of the dollar was certainly above suspicion before the crisis. Indeed it occupied until the autumn of 1931 a similar position to that of sterling before the war, and it was difficult to imagine any circumstance which could bring about a depreciation of the dollar in relation to gold.

(6) The New York money and discount markets have undergone considerable expansion since the war. From an international point of view, only the market for brokers' loans is of special significance. As pointed out above, the Wall Street boom resulted in the transfer of large amounts of foreign funds into New York for brokers' loans. There has, however, been no steady flow of foreign funds after the experience of 1929, and it is doubtful whether the same phenomenon will

repeat itself on a similar scale. On the other hand, the leading banks are fairly active as lenders and borrowers, to and from abroad, in terms of dollars, which is a steadier activity than that provided by the market for brokers' loans.

As it is obvious that international financial supremacy cannot be obtained by a centre unless it possesses a good discount market, certain American banking circles have endeavoured to develop the New York discount market. They formed an institution called the "Acceptance Council", whose task was to encourage the use of acceptance credit by means of propaganda. At the same time, firms similar to the discount houses of the London discount market were established. How far these efforts were responsible for the development of the New York discount market is difficult to ascertain. It has undoubtedly made spectacular progress as far as amounts are concerned. There is reason to believe, however, that the quality of the bills is inferior, from an international point of view, to that of the bills circulating in the London market. Thus while in London no acceptance credit is used to finance home trade, in New York a fairly large proportion of bills are drawn on such credits. What is more important is that in New York there has been a tendency to encourage rather than to discourage the use of finance bills. The market in promissory notes, called commercial paper, is of entirely local importance and does not attract any foreign funds.

(7) The New York foreign exchange market has made good progress since the war. Thanks to the establishment of cable and telephonic communications with a number of centres, its activity has greatly increased. It has an active market in Canadian and

South American exchanges, as well as in Far Eastern exchanges. The increasing tendency to establish direct relations between foreign centres and other American centres is, of course, detrimental to the New York market.

If we compare New York with London during the period between 1925 and 1931, we find that both centres had advantages over one another. The resources of each were very large. Taking their foreign security holdings—apart from political debts—London still held the lead, while, if we include political indebtedness, London was a close second to the United States. As far as current resources, represented by the surplus of trade balance, were concerned, the United States had the advantage over Great Britain. On the other hand, it is reasonable to assume that there was a steadier flow of foreign capital for investment in Great Britain than in the United States, and this was available for reinvestment abroad. As a banking organisation, the superiority of London—from the point of view of international business—was unquestioned. At the same time, it ought to be recognised that New York was making progress in that direction. In certain respects New York has already equalled London, while in others the discrepancy was likely to disappear sooner or later. In some fields, however, London was expected to remain always superior. As to the freedom of the market, there was very little to choose between London and New York. With regard to general confidence in the stability of the currency, New York had again the advantage. As to the attitude of the investing public towards foreign bonds, New York was incomparably inferior to London and presumably will remain so for a very long time. With regard to the

market for short-term funds, the superiority of London was also beyond doubt; but there was a possibility that New York would reduce the discrepancy. In the foreign exchange market, New York did not even attempt to vie with London.

The conclusion that was likely to be drawn by an impartial observer was that New York had not superseded London as the world's banking centre, and was not likely to do so. Although it is a natural and legitimate ambition on the part of the wealthiest nation in the world to endeavour to be first in regard to everything, those responsible for the financial policy of the United States were not expected to devote much energy towards the development of the international aspects of the New York market. The fact that the intense propaganda conducted in favour of abolishing the tax on interest earned by foreign funds had failed to produce any result was, in itself, a proof that the authorities in the United States were not anxious to support those endeavours.

CHAPTER VI

PARIS AFTER THE WAR

The war has affected the international position of Paris far more than that of London. As a result of the default of many of France's debtors, her external resources became depleted to a great extent after the war. Although French capital was exported on a large scale after the war, its export assumed the shape of a flight from the franc—a process hardly encouraging to the development of Paris as an international banking centre. In fact, from a lending nation France became a borrowing nation during the post-war period until about 1927, which, in itself, ruled out the possibility of maintaining an active international financial centre. There were other disqualifying factors; the franc underwent a sharp depreciation between 1919 and 1926 and fluctuated within very wide limits. It was, indeed, the most speculative exchange during the post-war period of foreign exchanges gambling. For several years, the franc was at the mercy of international speculation. A number of exchange restrictions and embargoes on the export and import of securities were adopted, and it was only quite recently that the last of them was removed.

This does not mean that during the dark days of inflation France had given up altogether the idea of

international financial expansion; in fact it was precisely the developments during that period that prepared the way for the spectacular recovery Paris made after the stabilisation of the franc. A considerable amount of French capital was exported, some of it without authorisation, to escape the effects of the depreciation of the franc, while some of it was exported in pursuance of a systematic policy of expansion. In spite of the depreciation of the franc and of bad financial conditions, the French Government and industrial and financial interests pursued an ambitious policy of expansion which had a strong political flavour. They endeavoured to establish themselves in countries which were in the French political sphere of influence, such as Poland, Roumania, Yugoslavia, etc. Far more important than this export of capital was the unauthorised flight from the franc. Large amounts of French funds took refuge in foreign centres, and since the franc was stabilised their owners have repatriated these funds. As a result, the Bank of France, through whose hands all these transactions passed, has accumulated an immense volume of foreign exchange reserves.

(1) As regards the post-war position of France's external resources, it is essential to differentiate between long-term and short-term credits abroad. We have already pointed out that the former have suffered a marked decline as a result of the complete or partial default of France's debtors. At the same time, there has been a spectacular increase in French short-term claims against other countries. The total of French investment abroad was probably substantially inferior to the pre-war total. Owing to the unusually large proportion of short-term investments, however, the monetary importance of French capital invested

abroad, from the point of view of international banking, very greatly increased. Long-term investments, it is true, have to be turned over from time to time, while the amounts received for interest and redemption have to be reinvested; but this is a gradual process. On the other hand, the whole amount of a liquid balance is available, at any given moment, for reinvestment abroad and represents a potential source of issuing activity. Moreover, liquid balances are more liable to frequent changes, such as transfers from one centre to another, or from one type of investment to another, than long-term securities.

The real significance of the French balances consisted, however, not so much in the actual and potential volume of activity they have supplied to the French financial centre, as in the potential danger they represented to international monetary stability. The shifting of these funds tended to disturb the foreign exchange market, and gave rise to inopportune gold movements. This whole question is, however, dealt with at greater length in a later chapter.

At the same time, since the completion of the reconstruction of the devastated areas, the French balance of trade has produced a considerable surplus every year, and this has inevitably increased the international financial importance of Paris.

We have to ask ourselves how far these favourable factors were of a permanent nature. It was obvious that the liquid balances would have to be reinvested sooner or later; in which case, they would cease to represent a power out of proportion to their amount. The favourable trade balance was largely the consequence of the stabilisation of the franc at a rather low level. The advantage attached to this was temporary,

and as soon as prices, wages, and the cost of living in France had adjusted themselves to the world level, the favourable balance was bound to disappear.

(2) The French banking system has certainly improved its equipment for dealing with international business. It has begun to specialise in foreign transactions. The system is, however, at a considerable disadvantage as compared with that of London, or even the minor Continental financial centres, mainly owing to the lack of an international mentality amongst French bankers. Their spirit of co-operation is weak. Indeed, the view is held in international banking circles that it is most difficult to do business jointly with French banks.

Apart from this, French banks are accustomed to think only in terms of small amounts. They carry conservatism, with regard to spreading the risk, to the extreme. If a transaction of only a few hundred thousand pounds is proposed, a French bank is not prepared to undertake it unless it can form a syndicate of about half a dozen banks to participate in the business. The hypnotic power of the million makes them overlook the fact that the million francs of to-day are only equivalent to 200,000 pre-war francs. They are, to-day, quite as circumspect at deciding about a transaction of a million francs as they were in pre-war days, although it only represents one-fifth of the pre-war amount.

Another shortcoming of the French banking system is the lack of initiative on the part of senior officials. Whereas in London the general manager of a bank has a free hand to conclude business transactions up to a fairly considerable amount—and makes full use of his freedom—in Paris, transactions of comparatively small

amounts have to be submitted to the preliminary approval of the board of directors. This means, of course, a delay which is a handicap in international competition. Other things being equal, the would-be borrower goes to a centre where he can get a prompt answer to his application for credit, rather than to a centre where he may be kept waiting for a week or more, only to be told afterwards that the bank is prepared to undertake one quarter or less of the amount proposed.

Another great disadvantage of the French banking system is the strong political atmosphere that prevails in Paris. The attitude of the French banks was influenced quite excessively by considerations of a political nature. If there was disagreement with a certain country, French banks immediately called in the credits they had granted to that country and declined to renew them. This has been done on more than one occasion to Germany. In 1929, when the Paris Conference of Reparations Experts was threatened with a deadlock, the Bank of France raised its rediscount rate for German bills, and the French banks called in all their outstanding credits, thereby causing their clients considerable inconvenience. In September, 1930, as a result of the victory of the National Socialist Party in Germany, the same situation arose, this time without any specific lead on the part of the authorities. This places the Paris market at a great disadvantage, as compared with other markets where political considerations are well in the background and influence banks only on occasions when they tend directly to affect the security of the credits. Other things being equal, would-be borrowers will always prefer to avoid a market where they are exposed to unpleasant sur-

prises on account of political developments over which they have no control.

It is not merely for reasons of a political nature that French bankers occasionally jump unpleasant surprises on their foreign clients. Apparently they have not yet acquired the tradition of nursing connections with foreign customers, and do not go out of their way to avoid causing them serious inconvenience. For instance, towards the end of 1928, credits granted to Austrian banks were called in suddenly to meet end-of-year requirements, without regard to the inconvenience caused thereby to their clients. It will take long years of experience for them to learn that it is a wise policy to consider the interest of customers.

(3) As regards the freedom of the Paris market, conditions have improved considerably during the last few years. Exchange restrictions and the embargo on the import and export of securities were removed, and in 1930 the taxation on foreign securities was reduced. The Paris market is open to foreign branches, but experience has shown that it is desirable to establish subsidiaries under French law.

The issue of foreign loans was subject to the approval of the authorities, and is likely to remain so. The authorities repeatedly exercised their right to veto issues, as they were guided by the consideration that all transactions must secure for France the maximum possible political and economic advantages. France is very anxious to finance the countries which are in the French sphere of political influence; such as Poland, and the little Entente. If any of these countries needs to issue a loan, the French authorities make it a condition to the participation of a French market that the international banking group engaged in the operation

should be headed by a French bank. If that is not the case, French banks decline to participate in the loan, and the authorities use their political influence in the borrowing country concerned to prevent the issue from being made. In many cases, the greater part of the loans granted to these countries has been provided by markets other than Paris, but, as the syndicate was managed by a French bank, France benefited to a full extent by the transaction from a political point of view. Another basis on which the authorities withhold their permission from a transaction is if it does not appear to result in an increased order for French goods. No loan the proceeds of which are to be used largely for the financing of contracts placed in countries other than France is ever likely to be authorised in Paris.

Yet another cause for vetoing foreign loan transactions is the existence of a pre-war debt which is not being paid in full. It is a well-established rule in every centre that no defaulting debtors can ever borrow unless and until they have undertaken to meet their liabilities. France, however, goes much further in this direction to protect the interests of French bondholders. If a disagreement exists as to the means of payment, whether the pre-war loan should be paid in gold francs or paper francs, the debtor is not allowed to borrow in Paris—not even if he has agreed to submit the case to international arbitration. In this respect, the existence of a disagreement with one single municipality is sufficient reason for vetoing any loan coming from that country. For instance, the French participation in the Japanese Conversion Loan in 1930 was vetoed on the ground that the city of Tokyo had not yet come to terms with French holders of its pre-war loan. What is more, even the existence of an agreement

in which French bondholders have actually consented to a concession to the debtors is insufficient. For instance, although the city of Vienna had concluded an agreement with the French bondholders, the French Government refused to authorise the French bankers to participate in the Austrian Government International Loan in 1930, unless the city of Vienna agreed to a revision of the existing agreement in favour of the French bondholders.

This policy may secure France advantages in individual cases, but is decidedly detrimental to the freedom of the Paris market, and tends to reduce the importance of Paris as an international financial centre.

(4) As to the extent to which foreign loans can be placed with the investing public, the change that has taken place since the war is for the worse. As was pointed out in Chapter III., the French small *rentier* used to be only too willing to acquire foreign securities; but as a result of the heavy losses French investors have suffered on their pre-war holdings of foreign securities, they are at present less ready to buy foreign bonds. For this reason, the absorbing capacity of the French market is limited. The change in their attitude was, however, not nearly as profound as many people, in France and abroad, are inclined to imagine. After all, French investors have lost a great deal more on their French securities than on their foreign securities, as a result of the depreciation of the franc. In spite of this, there has been a great demand for new French issues. The fact is, that the attitude of the French investor towards foreign loans has not been tested so far. Since the obstacles to foreign issues in Paris have been removed, conditions in the world market have been

anything but favourable to the issue of foreign bonds. The reluctance of the French investor to take up foreign bonds during this world-wide adverse trend cannot be regarded, therefore, as an indication of his attitude in the long run.

(5) As regards the stability of the French currency, it is necessary to discriminate between the short view and the long view. The possession of the second largest gold reserve, and an additional huge foreign exchange reserve, places the franc above suspicion. Taking the long view, however, opinions are somewhat less settled. Although the memory of the public is short in these matters, they have not yet forgotten altogether that until 1926 the franc depreciated as a result of inflation, that it fluctuated within very wide limits, and that it was eventually stabilised at a level corresponding to about one-fifth of its pre-war value. Undoubtedly, France would never repeat the experience of 1919–1926, except in cases of extreme emergency. But, taking the long view, the possibilities of extreme emergency cannot be altogether eliminated. Although everybody hopes for the best, another European war during the lifetime of the present generation is by no means out of the question. It may well be asked if, in case of the event, France could be trusted to do her utmost to pursue a sound monetary policy. Remembering recent experience, the answer is decidedly in the negative. Even though the possibility of a war is too remote to deter people from trusting the franc, any war scare may result in a wholesale efflux of funds, both French and foreign, from France.

(6) The French market for short loans is limited, and its international significance is small. Considerable efforts have been made, during the last year or two,

to develop a discount market. It has been realised that an international financial centre cannot claim supremacy unless it possesses a good discount market. For this reason, the French authorities have spared no effort to improve on existing facilities. While, originally, the object of these efforts was to develop the international importance of Paris, subsequently it has been realised that the development of a discount market was desirable also from the point of view of the domestic monetary system. Owing to the absence of facilities, in France, for liquid short-term investments, the French banks had to keep the greater part of their idle reserves abroad. This meant that whenever these funds were required in Paris, it was necessary for the banks to withdraw funds from foreign centres, thereby unsettling the exchanges. Apart from considerations of an international nature, this was contrary to the best interests of the French banks themselves; for if they try to repatriate their funds all at the same time, they are bound to suffer losses on the exchange. It was hoped that, by means of the development of a discount market, adequate facilities would be provided for the purpose of investing idle reserves in the domestic market.

To that end, a special bank was established in Paris in 1929, under the name of Banque Française d'Acceptation. It specialises in acceptance credits and, apart from its own acceptance credits, it also acts as intermediary to arrange credits with other French banks which participate in its share capital. One swallow does not, however, make a summer. The acceptance credit facilities in Paris are far from adequate to provide a sufficiently large amount of bills to secure an active market. Another disadvantage of the

Paris discount market is that French banks are not in the habit of keeping their reserves in bills to anything like the extent that banks in other countries keep their reserves in that form. There are no discount houses or bill brokers in Paris. The market, therefore, is decidedly a bad one. The margin between dealing rates is very wide; not infrequently, there is a discrepancy of ½ per cent between rates quoted in various banks for the same type of bill on the same day. For this reason, the Paris discount market did not attract any foreign funds until the crisis.

The mentality of French bankers is also an obstacle to the development of the discount market. Quick decision and willingness to grant acceptance credits of considerable amounts, or to discount bills for large sums, are preliminary conditions for the development of a good discount market. It is anything but helpful if would-be borrowers or holders of bills have to wait for a decision until the French bank which they approach with their offer has succeeded in forming a syndicate to participate in the amount. The lack of an experienced personnel is yet another obstacle, but this can be overcome much more easily than the lack of the right mentality.

(7) For the same reason, the Paris foreign exchange market is also far from adequate. If a French bank is approached for a quotation of exchange rates, it hardly ever quotes a firm buying and selling rate. The answer to inquiries as to rates is usually introduced by "*On dit* . . .", thereby evading responsibility for the rate quoted. French foreign exchange dealers are not, as a rule, authorised to carry positions, and transactions for large amounts have to be submitted to the approval of the management, which naturally handicaps

the activity of the dealers. The dealers have not got the same independent nature and initiative as in other centres. Red tape is carried to an extreme in French banking. Every item has to go through the hands of a number of officials before it assumes definite form. When paying in funds to a French bank, however small the amount may be, the receipt has to be signed by two senior officials, usually the manager and a holder of procuration, and very often the customers are kept waiting for some length of time. This system is anything but helpful to the development of an active foreign exchange market.

We have seen that, although in many respects Paris has made progress since the war, in several respects the situation has changed for the worse from the point of view of international banking activity. A comparison with London shows that in two respects, at least, Paris was superior, namely, as to the amount of her liquid balances available for reinvestment abroad and as to the confidence in the stability of the franc, taking a short view. This situation, however, was essentially temporary.

There are, on the other hand, several considerations in respect of which London has retained her lead as compared with Paris. The amount of foreign securities held in Great Britain is infinitely larger than the amount of French capital invested abroad. The banking organisation of London is incomparably superior, as regards international business, to that of Paris in almost every way. The London market has a greater freedom than the Paris market in most respects. The British investing public is more willing to absorb foreign securities than the French investing public, and, therefore, the absorbing capacity of London is

superior to that of the French market. While, as has been said above, the short view favours the franc as compared with sterling, the long view is most decidedly in favour of sterling. In spite of the efforts of the French authorities and banks to develop their discount market, there is no comparison between the two markets. Further, the Paris foreign exchange market is considerably inferior to London. In most respects there is ample scope for improvement in the French market, and it is possible that, within a few years, the discrepancy between Paris and London will not be so marked. The chances are, however, that there will always remain a difference in favour of London.

CHAPTER VII

NEW YORK *v.* LONDON

THE history of relations between London and New York since the war is calculated to prove that rivalry between two financial centres does not necessarily mean bitter fighting and cut-throat competition As was pointed out in Chapter I., the fight for international financial supremacy between London and New York was fought with due regard to the rules of the game. New York has proved a chivalrous opponent who readily assists its rival when it is in the general interest to do so.

As far as the official monetary authorities are concerned, there has been no sign of any rivalry whatever. On the contrary, almost immediately after the war a close co-operation was established between the Bank of England and the Federal Reserve authorities, and more especially with the Federal Reserve Bank of New York. This co-operation was largely due to the cordial relations existing between Mr. Montagu Norman, Governor of the Bank of England, and the late Mr. Benjamin Strong, Governor of the Federal Reserve Bank of New York until 1928. Mr. Strong was broad-minded enough to realise that, from an American point of view, it was more important to assist in the financial reconstruction of Europe than to pursue

ambitions of a rather illusory nature aiming at the permanent substitution of the dollar for the pound sterling as the international currency. He was also aware that the way from New York to Europe led through London, and that it would be impossible to achieve financial reconstruction on the Continent without the close co-operation of Great Britain. In order to be able to co-operate, Great Britain had to recover from the eclipse she suffered during and immediately after the war.

The American authorities remained, therefore, perfectly neutral in the so-called fight between the dollar and the pound. While desirous of increasing the use of the dollar, they realised that this was a secondary consideration from the American point of view. Had the management of the official monetary policy of the United States been in the hands of aggressive and ambitious people, pursuing a policy of prestige, they would have probably withheld all support from the British authorities, so as to gain time for the establishment of the dollar as the principal means of payment. Instead, the American monetary authorities gave valuable assistance to Great Britain when, in 1925, they granted a substantial stabilisation credit. It is even said that, on several occasions, the discount rate policy of the Federal Reserve Bank of New York was guided by a desire to help the Bank of England, though it is difficult to ascertain how much truth there is in this theory, which has been the basis of heated attacks against the Federal Reserve Bank of New York by the politicians of the Middle West. There is no doubt there has, however, been close co-operation in the fixing of rediscount rates between London and New York, and the discount rate policy

of New York was occasionally guided by a desire to help London; the service thus rendered was reciprocated on several occasions.

The same cordial relations that developed between the monetary authorities have also existed between banks in London and New York. In this respect, co-operation was based on century-old traditions. There are about half a dozen prominent private banking firms in London with associate houses in New York. Since the war, the relations existing between London and New York banks have been drawn closer. While, before the war, in most cases London joint-stock banks were unquestionably superior to their New York equivalents, the discrepancy has now disappeared; they now deal with each other as between equals, and often avail themselves of each other's assistance. Ever since the issue of the Austrian Reconstruction Loan, British and American bankers have co-operated in the floating of a number of foreign loans. As a rule, it has been found easy to come to terms with American banking groups.

If co-operation sometimes failed to produce satisfactory results it was due to the difficulty of isolating the American portion of the loans from the British portion. Although the latter was originally expressed in sterling and the former in dollars, this did not prevent the importation of a large amount of American bonds to the British market. It became a practice that when a joint issue was made, the bonds of the American portion were offered at a discount simultaneously with the issue of the British portion, much to the inconvenience of this market.

Thus, while, from a British point of view, the co-operation of the American market was undoubtedly

useful, the American banking interests also benefited to a great extent by co-operation. As was pointed out in a previous chapter, the absorbing capacity of the American investing public was comparatively small, even previous to the Wall Street boom. There was a tendency among American financial houses to undertake more than they could hope to handle successfully. In their keenness to participate in foreign issues, they often disregarded the limits of the absorbing capacity of their market. In order to be able to distribute issues for which they had assumed responsibility, they endeavoured to place a large part of them in London. To that end several leading American financial houses established branches or subsidiaries in London, whose main task was to approach insurance companies, and other big investors, to induce them to take over some of their dollar bonds. The practice of placing such bonds privately on a large scale became widespread, and although the amount of any individual transaction was comparatively moderate, with regard to the large number of issues part of which were placed here, the total amount of dollar bonds disposed of was considerable.

This practice was obviously against the interest of London as an international financial centre. As London's resources available for lending abroad have been rather limited since the war, it was obviously to her interest to reserve her resources for her own requirements and not those of a rival centre. The amount of dollar bonds placed in this country automatically diminished the amount available for lending directly to the regular customers of the London market. Even during the unofficial embargo on foreign loans in London, the practice continued unabated. This meant

that while London banks had to decline the offers of their customers and had to send them to their New York rivals, part of the loans granted by the latter were eventually raised in Great Britain and affected sterling to exactly the same extent as if a direct issue had been made in London. There is also another point of view from which the practice must be regarded as highly undesirable. To some extent the issue of foreign loans in London brings orders to British trade. If, however, the loan is issued in New York, and part of the bonds find their way to this country, British trade does not benefit by it.

The possibility of placing dollar bonds privately was, of course, limited by the absorbing capacity of insurance companies, investment trusts, and other large investors. The general investing public kept aloof from this type of investment, in spite of its higher rate of interest as compared with the equivalent sterling security. In this respect the instinct of the public, ignorant in matters of investment, proved to be sounder than the policy of well-informed and over-sophisticated large investors. Experience has shown that the smaller yield of foreign bonds issued in London is more than compensated by the advantage of a comparatively stable market. Almost all large investors who acquired dollar securities in the past have suffered very substantial capital depreciation during the last few years. Although it may be argued that, as they intend to hold these bonds until maturity, eventually they will not be losers, the argument is not convincing, as the necessity of carrying these bonds until maturity has probably prevented these investors from taking advantage of other investment opportunities. It is probable that the unfavourable result of this experience will tend

to discourage this practice in future. The attempt to induce the general public to buy dollar bonds, by means of introducing American methods of bond-selling, has failed completely. It may be in accordance with the requirements of the American public, but it is certainly not viewed with favour by British investors, to be called upon by travellers attempting to sell them bonds. As, in the past, only securities of a doubtful character were hawked about in this manner, the British investor instinctively distrusts such methods.

The placing of dollar bonds privately in this country is certainly the least desirable form of co-operation with the United States. If American financial houses feel that the amount they have undertaken to issue is beyond the absorbing capacity of their customers, then the obvious solution is to come to terms with British financial houses to float part of the issue in London, instead of attempting to place them here privately above the heads of their British correspondents.

Generally speaking, the attempt to make New York into an international financial centre was not guided by any political considerations. Towards Europe the United States has adopted, since the end of the régime of President Wilson, a policy of *désintéressement.* To give only one example of the essentially non-political character of the attitude of Washington towards the New York market, although the United States Government has been very keen on naval disarmament, it has never used financial weapons to bring pressure to bear upon the parties concerned. As far as countries of Latin America and the East are concerned, it must be admitted that the American authorities have made use of the financial power of New York to advance

political interests, but their object has not been primarily political, but mainly economic. Political influence was brought to bear merely to secure contracts for American interests. Although, in this respect, occasionally they have clashed with British interests, on the whole the fight has been without bitterness.

An example of the clash of economic interests of Great Britain and the United States, and of the way in which the New York financial market has been used to support the latter's interests, has been provided by the case of the Polish Loan. The international group which issued the Polish Stabilisation Loan was headed by an American firm, and, consequently, an American financial adviser was appointed—Mr. Dewey. There were frequent complaints against him on the part of British financial houses, industrial enterprises, and engineering contractors, and it was alleged that he used his influence to a great extent to secure advantages to American interests. Thus he is said to have vetoed the offers of British firms and to have favoured competing American offers, although the latter were not, by any means, more favourable to the interests of Poland. Another case is the activities of Dr. Milspaugh, the American financial adviser to the Persian Government. Although his appointment was not accompanied by any loan transaction, one of the reasons why he has such a strong position in Persia was the hope that, sooner or later, he would be able to obtain a large American loan for the country. It is a recognised fact that Dr. Milspaugh used his great influence to attempt to weaken the influence of British interests in Persia—especially that of the Anglo-Persian Oil Company. He did not, however, succeed in this object, and as his activities have decidedly improved the

finances of Persia, they were, in the long run, also beneficial from a British point of view.

The year 1927 constituted a turning-point in the relations between London and New York. Until then, New York's superiority was beyond question, and manifested itself both in competition and in collaboration with London. Since 1927, however, the international financial position of New York has been somewhat eclipsed. The last act of support given by New York to London was the reduction of the Federal Reserve Bank rate in August 1927. The late Governor Strong was subject to violent attacks on account of that move, which is held to be responsible for the Wall Street boom. He was accused of having jeopardised American interests in order to help London. Although it seems probable that the main motive of the reduction of the Bank Rate was to enable London to avoid raising its own Bank Rate, it seems unlikely that a reduction of ½ per cent should have been able, in itself, to bring about the enormous boom that went on during the following two years.

As a result of the general upward trend of American shares, the American investing public lost interest in foreign bonds. After the middle of 1928, foreign borrowing in New York was reduced to a minimum. In fact there was a strong tendency towards the repatriation of the European bonds issued in the United States during the previous three or four years. As the price of these bonds had declined considerably, they became attractive to the Governments and the investors of the borrowing countries, and were acquired by them on a large scale. At the same time, American banks gradually ceased to lend in the European money markets. While, until 1928, the

movement of American short-term funds to and from London was one of the principal factors in sterling and dollar exchange, after 1928 the major part of these funds was withdrawn owing to the more remunerative rates offered in the New York market for brokers' loans. Similarly, American funds also left Berlin and other European centres. What is more, European banks and other owners of liquid funds discovered the advantages of lending to Wall Street, and there was a very pronounced westward flow of liquid capital. Thus, from a lending centre, New York became a borrowing centre, both as regards long-term investments and short-term funds. Her borrowing assumed such enormous dimensions that it endangered the stability of the European exchanges and was responsible for a general upward movement of interest rates throughout the world.

As a result of this change, New York ceased to be able to assist other markets. Undoubtedly, the fluctuation of interest rates in the market for brokers' loans had a decisive influence over the international money market, and to that extent New York continued to control international tendencies throughout the boom, but there was no longer any deliberate policy to that end on the part of either the American authorities or the American banks. That they still had the control of the world's money markets was the outcome of their weakness rather than of their strength. On several occasions, they had to be assisted by the Bank of England, which institution had rapidly to raise its rediscount rate, mainly in order to discourage the flow of funds to New York, which was becoming a source of embarrassment to the American monetary authorities.

As a result of the slump in November, 1929, the rôle played by New York in international finance has further declined. The monetary authorities have been too much engaged, since the slump, with their domestic troubles to pay much attention to international affairs. As for the banks, their freedom of action has been curtailed by the necessity of carrying their excessive loans on securities. Although these loans were supposed to have been amply secured, the slump has eliminated the margin of cover, and the banks were unable to unload their stocks without fear of bringing about a further disastrous fall in values. This experience has proved the inadequate nature of brokers' loans as a type of short-term investment. Although in theory they may be well secured, in practice their liquidity in times of emergency leaves much to be desired. The present experience may contribute to discourage foreign capitalists from making direct loans to Wall Street. The greater part of European funds lent to Wall Street during the boom were lent through the intermediary of the leading American banks, and were, therefore, safe.

At the time of the slump, it was hoped that the American investing public would change over to fixed interest-bearing securities, and particularly to foreign bonds, but this has not, so far, been the case. A great part of the capital available for investment has been destroyed by the slump and by the subsequent trade depression. In any case, investors in America—as in other countries—are most reluctant to commit themselves in any direction owing to the obscurity of the outlook. Thus, there has not been any revival of foreign issues in New York. Nor has there been any noteworthy revival of lending of short-term funds, for the simple reason that American banks are still carrying

the loans they granted on securities, and are borrowers rather than lenders abroad. The bond market remains hopelessly congested, and the issue of new loans is as difficult as ever. For the time being, therefore, New York cannot either compete or collaborate with London to any great extent.

The experience of the last two years has decisively proved that New York can never rise to permanent supremacy as an international financial centre. Undoubtedly, she will recover in a few years from the temporary embarrassment caused by the slump, and will resume, once more, her international activity on a large scale. However, it is now obvious that her interest in international affairs will always remain of an essentially spasmodic nature. The United States is too much engaged in the development of her own resources to take a really keen permanent interest in international finance. The two domains of New York's activity are bound to clash from time to time, and on every such occasion the international aspect of the market will be overshadowed by the domestic. The speculative interest the public takes in American shares makes it difficult to get them permanently interested in foreign securities.

Although from time to time New York will rise to predominance in international finance, this, in itself, is not sufficient to justify the view that New York has acquired the lead. The market which aims at international financial supremacy has to devote to that end a steady and permanent attention. Sudden flares of interest, followed by reactions, are calculated to be detrimental in the long run to the international position of a centre. Other things being equal, would-be borrowers will always choose a centre which is not

exposed so greatly to the caprices of domestic developments as New York.

In some banking quarters in New York, the view is held that it would be worth while to make every possible effort to change the balance of the New York market from the national to the international. To that end, it is suggested that the discount market should be developed to the detriment of the market for brokers' loans by means of the introduction of fortnightly settlements on the New York Stock Exchange, as a result of which the amount required for financing speculation would diminish considerably and the funds thus released would help to forward and develop an active discount market. Those, however, who advocate this remedy do not seem to take into account the mentality of the American public. If speculation is driven to excess when settlements take place daily, the introduction of fortnightly settlements would provide further stimulus and would result in a further increase of the gambling spirit. This would be detrimental to the stability of the New York market, and would not be helpful to the development of the discount market. It is unlikely, therefore, that this remedy will ever be adopted. The New York discount market is likely to remain a comparatively neglected section of the financial market and will not endanger the supremacy of the London discount market.

CHAPTER VIII

PARIS *v.* LONDON

In order to appreciate the sudden revival of France's ambition to create a first-rate international market in Paris, and to attain supremacy in international finance, it is necessary to understand French political mentality. It is a well-known fact that in no country is the atmosphere so essentially political as in France. While in Great Britain and other countries foreign policy is largely governed by economic considerations, in France economic activity is largely determined by political considerations. If France is anxious to attain financial supremacy, it is not so much on account of the immediate financial benefit obtained therefrom as on account of the political power it represents.

For several years, France was at the mercy of international finance. The franc was the principal gambling counter in foreign exchange markets from Vienna to Buenos Aires. It was a decidedly humiliating experience for a great nation, and it is only natural that everything should be attempted to avoid the repetition of this experience. It is a time-honoured military slogan that the best defence is to attack. In order to protect herself against the tyranny of international finance, France has endeavoured to beat international finance on its own ground by establishing herself as a first-rate

financial power. After having been in an inferior position, French high finance was most anxious to take the first opportunity to make itself felt once more as an active factor instead of a passive one. Rightly or wrongly, international financial circles in foreign centres are credited in France with having pursued an anti-French policy. They are credited with having endeavoured to induce various Governments to prevent France from enjoying the fruits of her victory. This belief is not altogether without foundation. Apart from the fact that German elements are strongly represented in every international centre, financial interests in almost every country have been inclined to favour Germany against France since the war. This was due, however, to their desire to accelerate the financial reconstruction of Europe. They were not pro-Germans, but pro-reconstructionalists. As they regarded the policy of France which culminated in the occupation of the Ruhr as the chief obstacle to financial reconstruction, they used their influence against France.

Whether or not they were justified is a matter of secondary importance from the point of view of our inquiry. Their attitude was against the apparent immediate interests of France, and this was sufficient to evoke in France the desire to be in a better position in the future for coping with them. If she became strong enough in that domain, she might be able, in the future, to counteract the influences set into motion against French policy after the war.

Another reason why the French have endeavoured to establish an international financial centre of predominant importance is that France had to restore the stability of her currency almost entirely without any

support from the other financial centres. While support was generously forthcoming to assist Germany, Austria, Hungary, Bulgaria, Poland, Greece, and Belgium, France did not succeed in getting any assistance in the shape of stabilisation loans or stabilisation credits. The only noteworthy support the authorities received from abroad was in 1924, when a British banking group, headed by Lazard Brothers & Co., and an American banking group, headed by J. P. Morgan & Co., granted France a substantial credit to support the franc. Otherwise, the only support received was in the shape of loans granted to French railway companies and public utility enterprises in foreign centres. No credit was granted to the Bank of France by any group of central banks, nor any stabilisation loan to the Government. It is said that on two occasions at least the Bank of France approached the Bank of England for assistance, but no arrangement could be arrived at. It is not unreasonable to assume that the unwillingness of the Bank of England to assist the Bank of France in the stabilisation of the franc was largely responsible for the latter's attitude in 1927 and in subsequent years, which will be dealt with later in this chapter.

It is necessary, however, to point out that support was not withheld without reason. In the first place, France refused to consolidate her inter-Allied debts to Great Britain and the United States until 1926, and the debt-funding agreements were not ratified until 1929. As it was a general rule adopted by both the above countries not to grant any Government new loans until its War Debt was re-funded, no exception could be made in favour of France, especially as she was in a better position to pay than any other debtor.

Apart from this, the general financial situation of France was also such as to make it appear undesirable, even from a French point of view, to grant credits or loans for stabilisation purposes. Until the second half of 1926, no serious efforts were made to balance the Budget by means of increased taxation. Had stabilisation credits been granted before the Budget was balanced there would have been no apparent inducement for the French Government to face the unpopularity of draconic fiscal measures with the object of balancing the Budget, and thus preventing a further fall of the franc. French taxpayers could not have been convinced of the necessity for making heroic fiscal sacrifice if it had not been for the very real threat that the franc would collapse. Thus it was a blessing in disguise that foreign centres withheld their support from France. It is, of course, understandable that very few people on the other side of the Channel should realise this.

Anyhow, rightly or wrongly, at the moment of the *de facto* stabilisation of the franc, the mentality of the French authorities and of Paris *haute finance* was marked by a feeling of bitterness against international finance, and a desire to get even with it for the humiliating rebukes they had had to endure for so many years. Human nature being what it is, it is only natural that, when they acquired the power to do so, they should take an early opportunity to retaliate.

The first clash occurred in the early part of 1927. The Bank of France was anxious to liquidate its secured indebtedness towards the Bank of England, contracted during the war, which had been gradually reduced and which at that time amounted to about £33 millions. Against this, a security of about £18

millions of gold was held in the Bank of England. Although the credit was not due for some time, the Bank of France expressed its desire to repay those credits out of its accumulated balances in London and to withdraw the £18 millions of gold thereby released. Apparently what the French authorities had in mind was merely to obtain a revision of the terms of the agreement. There is reason to believe that they worked on the assumption that the £18 millions of gold existed no longer, as the Bank of England was supposed to have used it during the war for the support of sterling. They considered it unfair, therefore, to pay interest on £33 millions while the actual amount was, in their opinion, only the difference between the £18 millions and the credit of £33 millions. Much to their surprise, the Bank of England declared itself willing to restore the gold deposit the moment the credit was repaid, thereby disproving the assumption that the deposit was used up. The settlement of the affair in this way caused a considerable amount of irritation in Paris, and to emphasise this, in May and June, 1927, the Bank of France withdrew gold from the Bank of England on several occasions. As it was a matter of common knowledge that the French balances in London were considerable, even after the repayment of the credit of £33 millions, it was feared that, should these withdrawals be continued, they would cause serious embarrassment to the London money market. The French attitude was subject to severe criticism in the London Press. About the details and technical explanations of this situation, more will be said in the next chapter. It is sufficient to point out here that the French authorities eventually agreed to refrain from making direct gold withdrawals from the Bank of England. At the

Conference of central banks held in August, 1927, in Washington, the principle of non-interference between central banks with each other's gold reserve was adopted. This means that central banks have agreed not to withdraw from each other any gold without the consent of the bank whose gold reserve is thereby diminished.

It must be acknowledged that in agreeing to this the French authorities showed their willingness to co-operate. The question is, however, whether this willingness existed in practice or only in theory. While there have not been any more gold withdrawals on account of the Bank of France since the agreement, there have been a number of withdrawals which—rightly or wrongly—have been attributed indirectly to the policy of the Bank of France. Technically they were ordinary commercial transactions, but many people were inclined to regard them as special transactions stimulated by French authorities.

The Paris market thus succeeded in making itself felt as soon as it had recovered its strength. Its first action was destructive rather than constructive, but it was followed by efforts of a constructive nature. It decided to develop a discount market of considerable importance. The scheme was not unanimously approved by every shade of French public opinion. In some quarters the view was held that, if France was desirous of restoring her pre-war standard as an international centre, she should concentrate her efforts on the development of the market for long-term loans, rather than on the development of the discount market. As was pointed out before, while Paris was important in pre-war days as a capital market, she was of little importance as a discount market. In spite of

this, efforts have been made for the creation of a discount market, while comparatively little has been done so far to bring about a resumption of French lending abroad in the shape of long-term loans. It would be a mistake to interpret this endeavour for the establishment of a discount market as a blow directed against London's position. Every centre has the right to attempt to improve its facilities, and a good discount market is decidedly one of the most important fundamental conditions of international financial supremacy. While, therefore, the gold policy of the French authorities—if it be responsible for the excessive import of gold—may be open to criticism, their policy aiming at the development of a discount market cannot be accused of being aggressive.

It is, of course, difficult to say how the Paris discount market will develop, but at present it cannot be regarded as a serious rival to London. As we stated in Chapter VI., its technical facilities are far from adequate, and the mentality and traditions of French banks are also against rapid expansion.

Another sphere in which Paris has attempted to rival London was the market for long-term loans. To some extent there has been co-operation, but this co-operation has assumed the shape of British participation in loans issued under the auspices of French groups rather than the reverse. In the course of 1930, almost every attempt to induce French banks to participate in international loans failed. For instance, in the case of the State of San Paolo Loan, participation was refused at the eleventh hour, as the French banking interests involved were said to have insisted that the bonds of the loan should be international in character and should be transferable from one market to

another. This same claim was upheld in every case when negotiations were carried on for the issue of an international loan with French participation. There is reason to believe, therefore, that this represented the wish of the French authorities. The other members of the banking group were unwilling to accept a condition that would have exposed their market to influences from other markets. London banking interests were afraid that if bonds were marketable indiscriminately in London and Paris, large blocks of the French issue might be suddenly unloaded in London.

In the case of other international loans, French interests put forward a variety of excuses for declining to co-operate in the issue. These and other symptoms seem to indicate that the French authorities and banking interests are, for the present, not at all keen on participating in loans, unless they are the leaders of the group. In the case of the Yugoslav loan negotiations, for instance, they categorically refused to participate in the international group formed under the leadership of a London banking house, and made a competing offer to the Yugoslav Government.

Considerations of prestige play a great part in the attitude of the French market towards loans. The French authorities have shown themselves most anxious that countries which are the political followers of France should not cover their loan requirements in centres other than Paris. At the same time, one cannot regard the reluctance of the Paris market to grant long-term loans as the outcome solely of political considerations; for they were not very anxious to grant loans, even to the political followers.

While the French market for long-term loans was not particularly active during 1930, France still con-

tinued to issue loans abroad. The object of these loans was the conversion of old issues. This does not alter the fact, however, that Paris remained to some extent a borrowing centre, a fact which was certainly detrimental to her international financial position. Everything seemed to indicate that the authorities were not anxious to encourage lending abroad because they did not wish to reduce France's liquid foreign balances. As will be explained in the next chapter, these balances—because of their liquidity—represent a far greater power than an equivalent amount of capital invested in long-term loans. The authorities were apparently desirous of retaining the weapon represented by these balances, which could be used much more effectively so long as they were thoroughly liquid. The French foreign trade position greatly assisted the French Government in its policy. As the franc was stabilised at a low level, French export trade has received a stimulus which has not yet completely disappeared. As a result, the French balance of trade, including invisible items, has shown considerable surpluses during the last few years. Far from declining, the amount of liquid balances abroad has shown until recently a tendency to increase.

The insistence of the French authorities on making any foreign bonds issued in France international in character, also seemed to aim at the same end, namely, that, at any moment, these long-term investments should be reconvertible into liquid balances. This desire of the French led to a clash between the British and French representatives at the Paris negotiations for the issue of the first instalment of the Reparations loan. As France was the principal beneficiary of the commercialisation of the Reparation debt, it

was expected that she should take over the greater part of the Reparations bonds. In the course of the negotiations, however, the French authorities endeavoured to fix at as low a level as possible the amount of bonds to be issued in Paris. At the same time, they insisted that the bonds should be made international, so that they should be able to circulate freely between the various markets. On this point, however, the British delegates adopted a very firm attitude, and, on the provisions of the Young Plan, insisted that the Reparations loan should be issued only in terms of the currency of the country in which it was issued. They wanted to avoid thereby a sudden flow of Reparations bonds to the London market, which could have otherwise become a very important potential source of danger to the stability of sterling. Eventually the French authorities had to accept the British point of view, and the bonds were made non-interchangeable.

Although the existence of a certain amount of securities that have free access to several markets is desirable, an excessive amount of such international counters may endanger international monetary stability. We have seen during the boom of 1929 how the flow of funds represented by the buying and selling of American shares on European account affected the exchange situation in Europe. The same phenomenon might have easily repeated itself in the case of the Reparations bonds; since it was impossible to foresee the total amount to be issued within the next few years, the extent of the danger could not even be measured. It was only natural that various markets should be anxious to take measures of precaution against being flooded with such bonds. The case of France, however, was totally different. There was no hope of placing with

the French public large quantities of these bonds as, for sentimental reasons, the French investor was most unlikely to acquire German securities; consequently, the greater part of even the first instalment was left with the issuing group and had to be carried by the banks, and, to some extent, by the French authorities. As large amounts of these bonds were believed to have been held by bankers and possibly the Government, it would always be possible to unload these amounts in foreign centres without regard to the market price. If the British authorities had agreed to make the bonds international, the result would have been equivalent to a potential increase of French balances in London, which was the last thing to be desired. Even as it was, the French balances were far too large, and were a constant source of danger. Their movement might have caused considerable inconvenience to the London market. In this respect, New York was also at a disadvantage, for the French balances in that centre were sufficiently large to make themselves felt, in spite of the larger gold surplus that existed in the United States.

It appears that, while in the case of New York collaboration with London was the rule and competition the exception, in the case of Paris, rivalry was the rule and collaboration the exception. For this reason the attitude of France in the fight for financial supremacy deserves particularly close attention. In the two following chapters, we propose to go into the details of the policy pursued by France before the crisis, with special regard to the French balances abroad and the French gold imports.

CHAPTER IX

THE FRENCH BALANCES ABROAD

We have seen in the two previous chapters that there have been two factors which have endangered international monetary stability, namely, the Wall Street situation and the French balances abroad. While the former was essentially a temporary factor, the latter was of a lasting nature. French balances have assumed considerable importance in the international money market ever since 1927. They were a factor to be reckoned with. We propose to examine in this chapter the origin of these much-discussed balances, the effect of their existence, and the chances of their disappearance or of their reduction to normal proportions.

According to one theory, the French balances were created by the purchase of francs by foreign speculators during the period 1926–1928. As the franc appreciated during the second part of 1926 from about 250 to 124 to the pound, it was then believed that the appreciation might continue, and that the French monetary authorities had it in mind to restore the pre-war value of the franc. As a result, there was a strong demand for francs on the part of foreign speculators, and the French authorities, in order to prevent a further appreciation of the franc, had to buy all the foreign currencies offered in connection with this

demand. Unquestionably this factor may have been originally responsible for the accumulation of a substantial amount of foreign exchange reserve by the French authorities. The fact that they allowed about a year and a half to elapse between the actual stabilisation of the franc and its legal stabilisation gave rise to the assumption that they wanted to encourage this process. So long as there was a possibility of a further appreciation of the franc there was also a demand on the part of foreign speculators.

Although speculation certainly contributed to the accumulation of foreign balances, its rôle in the creation of those balances is grossly exaggerated. After all, once the franc was legally stabilised there was no longer any object in keeping foreign balances in the hope of a further appreciation, and those balances were probably withdrawn without exception, as money rates in France have been anything but attractive since 1928. It is thus obvious that speculative demand for the franc from 1926 to 1928 contributed only temporarily to the increase of balances. The fact that, after the legal stabilisation of the franc, there was no wholesale withdrawal of funds from Paris shows that the amount held by foreign speculators was not nearly as large as was popularly believed.

If international speculation played a certain part in the origin of the French balances, it was before and not during the period of stability. Towards the middle of 1926, when it appeared as if the franc would follow the mark and other continental currencies in its depreciation, the whole world was speculating against it. There was a huge bear position in francs in every centre, and international speculators who had sold francs short when the rate was anything between 175 and 250 to

the pound, found, as a result of the sudden appreciation of the franc, that they had to cover their position at rates varying between 175 and 125 to the pound. Although it is impossible to estimate even approximately the amount involved, or the average rate at which the francs were sold and repurchased by speculators, it is certain that the difference was very considerable, and that it contributed to no slight extent to the accumulation of French balances. Thus France fully avenged herself on international speculators for the harm the latter did her prior to 1926. Apart from the moral satisfaction of her victory, she received also a very material indemnity in the shape of the profit arising from squeezing bears in francs.

This, however, does not, in itself, explain the creation of the huge French balances which were at one time somewhere in the neighbourhood of £300,000,000. By far the greater part of this amount was due to the return to France of French funds which took refuge abroad during the period of inflation. As we pointed out before, restrictions imposed upon the transfer of capital from France failed to prevent the wholesale flight of funds. It was mainly French holders of funds abroad, rather than foreign speculators, who hastened to transfer their funds to France so as to take advantage of a further appreciation of the exchange. While, as we said above, foreign speculators withdrew their funds as soon as their hopes of capital appreciation had vanished, French capitalists retained them in their country, thereby contributing permanently to the creation of the external balances held by the authorities. All that happened in reality was that the funds held abroad were transferred from the hands of many thousands of in-

dividual investors to those of the banks, the Bank of France, and the Treasury. While formerly the major part of these funds was kept in the shape of foreign securities, after the transfer it was kept in the form of liquid balances, holdings of commercial bills, or Treasury bills, and time deposits.

When speaking of the French balances, it is necessary to discriminate between three categories, viz. the foreign balances of the Bank of France, those of the French Treasury, and those held by French banks. The first was by far the largest. The amount of Bank of France balances in London was at one time as high as £140 millions, while the amount held in New York was also very large. In 1928 the Treasury held substantial balances in London to meet the requirements of the war debt and other external liabilities of the Government. The amount of the Treasury's balance in this market has declined, however, considerably during 1930. Part of it was used for the repayment of external loans guaranteed by the French Government, while part of it was transferred to the Bank for International Settlements. The Bank of France has also reduced her balances, mainly through transferring large amounts to New York. In September, 1931, its sterling balances amounted to £62 millions only. As for the amount of sterling balances held by French banks other than the Bank of France, it was impossible to make an even approximate estimate. They were subject to wide fluctuations, and their movements caused a good deal of inconvenience.

As stated in the previous chapter, the possession of these huge liquid balances carried considerable advantages for France, of which the following were the main:

(1) It markedly strengthened her international financial position, and enabled her to make herself felt in international finance soon after the stabilisation of her exchange.

(2) It enabled her to restore confidence in the stability of the franc. After the experience of 1919–1926, it would have taken, under normal conditions, at least a decade to make the holders of francs—both in France and abroad—forget their disastrous experiences. As it is, the franc is now considered one of the safest currencies, thanks to France's possession of huge external balances.

(3) It restored the financial prestige of France abroad. Would-be borrowers are aware that, possessing those balances, France is in a position to lend them.

(4) It placed a powerful weapon at the disposal of the French authorities, with the aid of which they are in a position to bring financial and even political pressure to bear upon other countries.

In spite of these advantages, many people in France would have preferred to see a decline in the French balances abroad. They were considered to be the least desirable way of investing French capital in foreign countries for the following reasons:

(1) The rate of interest on short-term investments has declined to a great extent during the last few years. Even while it was high, the French authorities could not take full advantage of it, for they were not in a position to make direct loans to brokers. Since the decline of money rates in 1930, these balances hardly yielded more than an average of 2 per cent per annum. On the other hand, had these holdings been converted into long-term investments, they could have yielded an average of 7 per cent per annum.

Assuming that the amount of liquid balances was £300,000,000, this difference is equivalent to the loss of interest of £15,000,000 per annum.

(2) Though the possession of the liquid balances increased the strength and the prestige of the Paris market, it helped, at the same time, the two rival centres. After all, these balances were placed at the disposal of British and American banks, which could make use of them to their own advantage, and could relend them to foreign countries.

(3) The existence of liquid balances did not benefit French trade. Had these funds been used for lending to foreign countries, they would have brought in orders for French goods, and would have secured the control of foreign enterprises.

(4) The existence of the French balances controlled by the authorities was a constant source of irritation abroad, and inspired distrust of France. Whenever the franc moved against sterling, the hand of the French authorities was suspected behind the adverse tendency. The belief that France was the principal cause of disturbing tendencies in the international money market was becoming more and more general.

For all these reasons, there was a strong feeling in influential French quarters that these balances should be liquidated. To that end, the Finance Act of 1930 has provided for the repayment of the French loans issued abroad under Government guarantee during the post-war period. As these loans pay an interest of 6 to 7 per cent, the saving obtained from their conversion into internal loans on a 4 per cent basis was considerable. The amount involved, however, did not represent more than a small fraction of the French balances abroad.

There were two alternative ways of disposing of the rest: either by the import of gold, or by resuming the issue of foreign loans and the introduction of foreign securities into France. We shall see in the next chapter that the first alternative has been chosen. Although fiscal obstacles to the issue of foreign securities were reduced, it seemed that the French authorities were not at all keen on bringing about a rapid reduction of their balances by means of lending abroad.

CHAPTER X

THE FRENCH GOLD IMPORTS

We have seen in the previous chapters that, ever since 1927, Paris has, from time to time, proved to be a disturbing factor in the international money market. How far has this been the inevitable result of circumstances over which the French authorities have had no control, and how far has it been the outcome of deliberate policy? This question has been the subject of heated controversy.

Until the legal stabilisation of the franc in June, 1928, there was a persistent demand for francs on the part of foreign speculators who hoped for further appreciation. When, in May and June, 1927, the French authorities withdrew gold from London, their explanation was that the object of these withdrawals was to create stringent monetary conditions in the London market, in order to check the demand for French currency, which was said to be becoming embarrassing to the French authorities. The argument was hardly convincing, as no country has the right to interfere, by means of direct action, with the situation in the money market of another country. The Bank of France was at liberty to check the inflow of funds by means of a reduction of the Bank Rate, but it was certainly pursuing an aggressive policy when it took upon

itself to create stringent conditions in another money market. For this reason, the sharp criticism of its action by the British Press was fully justified.

M. Poincaré, the then Prime Minister and Minister of Finance, who is known to have inspired the policy of the Bank of France, is said to have adopted the line of argument that, as Great Britain enjoyed the advantages of having returned to the gold standard, she should also put up with its inconveniences. On the other hand, the British authorities are credited with having answered that the freedom of the gold market had not been re-established for the convenience of authorities of other countries anxious to increase their gold reserves, but for the purpose of meeting normal commercial demands. It is to the credit of the French authorities that eventually they realised the necessity of adopting a more conciliatory policy. It is beyond doubt that if the French authorities had made full use of their power to withdraw gold, it would have created an embarrassing situation, and would have resulted in a set-back to the progress towards international monetary stability. It was, therefore, obviously also to the interest of the French authorities themselves to refrain from taking advantage of their right to withdraw gold. It is, nevertheless, to their credit that they adopted a reasonable policy by agreeing in Washington to refrain from further gold withdrawals.

Since the legal stabilisation of the franc in 1928, the exchange has been almost continuously at a premium in relation to sterling, dollar, and guilder, and, as a result, private arbitrage from time to time has shipped large quantities of gold from London, New York, and Amsterdam to Paris, with the conseqence that the

French gold reserve has increased at the beginning of 1930 to the formidable figure of £420,000,000, as compared with about £800,000,000 in the United States, and only about £150 to £160 millions in Great Britain. We have to ask how far the firmness of the franc, which brought about the influx of gold, was due to the deliberate policy of the French authorities, aiming at an increase of the gold reserve. The opinions prevailing in various quarters may be summarised as follows:

(1) According to one theory, from time to time the French authorities made use of their influence over the exchanges to bring about an import of gold for considerations of a political nature.

(2) The French authorities are also said to have encouraged the import of gold in order to increase the importance of Paris as an international financial centre.

(3) The French authorities, although they did not actually encourage the influx of gold, adopted a policy of benevolent neutrality towards the movement, and did not make any effort to check it.

(4) The French authorities were helpless against the movement, which caused them considerable embarrassment.

Those who believe that the influx of gold into France was due to the deliberate policy pursued by the French authorities for political ends, base their assumption on the fact that, whenever relations between the British and the French authorities became strained, the exchange always moved against this country and gold was withdrawn. The first instance of this was in June, 1929, after the victory of the Labour Party at the General Election. Mr. Snowden's anti-French attitude then coincided with withdrawals of gold on French

account. Subsequently, during the first conference of The Hague in August, 1929, which witnessed a serious clash between the French and British delegates, there were further heavy withdrawals. It is said that Mr. Snowden's remark to the Conference that M. Chéron was talking nonsense cost the Bank of England many millions of pounds of gold. Another conspicuous example was after the clash of British and French interests in Paris in May and June, 1930, in connection with the negotiations for the Reparations bonds issue, which was referred to in the previous chapter. The French authorities resented the insistence of the British authorities that the whole of the proceeds of reparation bonds issued in London should be retained by the British Treasury. Within a few weeks of the issue, an amount of gold practically equivalent to the British share of the Reparations issue was gradually withdrawn on French account, and M. Frédéric Jenny triumphantly pointed out in the *Temps* that it was useless to insist on retaining the proceeds of the London issue of Reparations bonds, as gold was nevertheless withdrawn.

Many people are, of course, inclined to give the French Government the benefit of the doubt. As the disagreement was always accompanied by a fair amount of publicity, it is possible that the market discounted any possible action on the part of the authorities, so that the exchange depreciated without any actual intervention. At the time of writing the earlier editions of this book, the author was inclined to take this charitable view, but in the light of subsequent events, as well as of information that came subsequently to his notice, he felt compelled to modify his conclusion. His two books published subsequently to

the previous editions of the present book, *Behind the Scenes of International Finance* and *Finance and Politics*, go into the details of the question.

The second theory, according to which, although the French authorities are responsible for the firmness of the franc which has brought about the inflow of gold, they have not been guided by political considerations, appeared to be more acceptable to the majority of banking opinion. It is a well-known fact that, even before the war, the Bank of France was always anxious to hoard gold. After the dark period of inflation and fluctuating exchanges, it was only natural that the old policy should be resumed as soon as possible. To some extent it was necessary to acquire a large gold stock in order to restore confidence in the franc at home and abroad.

It was seen that, in the case of New York, a large gold reserve had contributed to the development of her international financial importance. On the surface, therefore, it appeared expedient from the French point of view to acquire a large gold reserve to the same end. The difference was that the inflow of gold to the United States was the inevitable consequence of war and post-war conditions; while, according to the theory in question, the inflow of gold in France was artificially stimulated.

As was pointed out in the introductory chapter, the size of the gold reserve does not, by any means, determine the international importance of the market. It certainly gives the holder of the gold reserve a feeling of confidence, and it makes the market less dependent upon temporary tendencies, but, in the long run, it does not determine the extent to which a centre can play the part of the world's banker. It was a mistake,

therefore, to attach such great importance to the size of a gold reserve from the point of view of the fight for international financial supremacy.

The third theory, that although the French authorities did not take the initiative in bringing about the appreciation of the exchange which was responsible for the inflow of gold, they nevertheless carefully avoided making use of the power they possessed to prevent such an inflow, differs from the previous theory only in degree. There is little to choose between actually encouraging certain tendencies and abstaining from counteracting them if the power to do the latter is at one's disposal.

Whenever the French authorities defended themselves against the accusation of deliberately bringing about the influx of gold, they were at pains to emphasise that the deficiencies of the technical organisation of the market, and the rigidity of the statutes of the Bank of France, prevented them from remedying the evil of the gold inflow. It is difficult, however, to convince intelligent opinion that such technical obstacles could not have been overcome, had there been a real desire to do so. After all, the statutes of the Bank of France are subject to alteration by means of legislation, and if the French authorities really considered the gold influx inconvenient, they would certainly have been in a position to pass the necessary laws enabling the Bank of France to carry out operations to counteract the appreciation of the franc.

It may be objected that the increase of the French balances abroad, as a result of an excessive purchase of foreign exchange by the Bank of France, was anything but desirable. In fact, some quarters were inclined to hold the view that the withdrawal of gold was

preferable, as it tended to reduce the French balances. This argument, however, was hardly convincing, as the worst possible result of the existence of excessive quantities of French balances is that they may be withdrawn in the form of gold. The actual withdrawal of gold was not to be preferred to the existence of a possibility of withdrawal.

According to the fourth theory, which was put forward by the French authorities, France was a victim of the influx of gold, against which she had no means of defending herself. The authorities had done their best to encourage lending abroad, but the French public was reluctant to acquire foreign bonds. The freedom of action of the Bank of France is restricted by legislation enacted under Napoleon I., which forbids it to do anything that is not expressly set out in its statutes. This same theory also considers the inadequate facilities of the French money market as a contributory cause to the withdrawal of gold. As there were no adequate facilities in Paris for the investment of idle reserves in liquid form, the French banks had to keep these reserves in London and elsewhere. Whenever these funds were required, whether for the purpose of the end-of-month settlements or for any exceptional purpose—such as the subscription to the shares of the Bank for International Settlements, or the increase of the cash reserve of banks, necessitated by the Oustric crisis—it was necessary to withdraw balances from abroad. This again tended to result in the appreciation of the franc and a flow of gold to Paris. This theory sounds very plausible, but for the fact that the tendencies have always been rather one-sidedly in favour of the withdrawal of funds to Paris. If it was true that the balances were required month after month

for the monthly settlements, it is difficult to explain why those balances were not returned to London after the turn of the month, and why they did not provoke a corresponding depreciation of the franc. Undoubtedly, the heavy applications for the shares of the Bank for International Settlements necessitated considerable withdrawals of funds from London. These funds were not however, returned, even after the allotment of the Bank for International Settlements' shares.

From an international point of view, the disadvantages of the hoarding of gold in France were only too obvious. In the opinion of a number of prominent economists, the flow of gold to France was largely responsible for the decline of the world price level during 1929 and 1930, and was thus a contributory cause of the world-wide trade depression. Although it may be one-sided and exaggerated to put all the blame for the fall of prices upon the French gold policy, it is none the less certain that the withdrawal of gold from other markets to Paris was a very important factor, and had a large share in the responsibility for the international economic crisis. The persistent firmness of the French exchange and the frequent withdrawals of gold were, moreover, detrimental to international monetary stability and tended to undermine confidence.

From a British point of view, the hoarding of gold by France was particularly inconvenient, because London had to bear the major part of the burden. Between 1929 and 1931, sterling was always at a discount in relation to the franc, and most of the time it has been in the close vicinity of the gold export point. In fact, on several occasions since June, 1930, it actually declined below its normal gold export point, owing

to special circumstances which require detailed explanation.

At the beginning of June, 1930, the Bank of England discontinued the paying out of bars of fine gold, and supplied only bars of standard fineness (·916⅔). The reason for this decision was that its stock of bars of fine gold had become depleted. On the other hand, the Bank of France refused to accept bars of gold inferior to a fineness of ·995. As a result, gold withdrawn from the Bank of England had to be refined first before it could be delivered in Paris. This meant additional expense and delay, in consequence of which the gold export point of the sterling-franc rate declined from about 123·89 to a figure that depended upon the refining charge. As the refining charge was subject to frequent alteration the new gold point changed accordingly.

In addition, even this variable gold point (which may be named a "relative gold point") was valid only for an amount of £300,000 to £350,000 per day, which was about the limit of the total capacity of the refiners in London and Paris. Thus, if on any given day the demand for francs exceeded that amount, it brought about the depreciation of the exchange considerably below the rate which was the gold point for £350,000 on that particular day. This fact gave the impression that, for amounts exceeding that figure, there was no gold point at all, and that, in case of particularly heavy demand for francs, sterling might have depreciated to an unlimited extent.

This was a mistake, however, and a dangerous one, as it was calculated to undermine confidence in sterling. The fact is that the sterling-franc rate continued to have an absolute gold point for the transfer of un-

limited amounts of gold, which was determined by the cost of triangular arbitrage operations. As the Reichsbank, for instance, was prepared to accept bars of standard fineness and was also prepared to pay out fine gold bars, the lowest rate to which the sterling-franc rate can decline was determined by the expenses of the shipment of gold from London to Paris via Berlin. This rate is calculated at about 123·45. In practice, of course, had such operations been carried out on a large scale, the depletion of the Reichsbank's fine gold bar stock would have compelled it either to stop accepting bars of standard fineness or to stop paying out bars of ·995 fineness. Three of the central banks—the Swiss National Bank, the Netherlands Bank, and the National Bank of Belgium—found it necessary to resort to the former alternative in anticipation of a depletion of their fine gold stock. Even if the Reichsbank had followed their example, there would have remained the theoretical possibility of shipping standard gold to New York, and then shipping fine gold from New York to Paris. Such operations would be, of course, too absurd to be considered seriously; it is, nevertheless, important to lay down the fact that they were possible to a practically unlimited extent, and that the expense of such operations determined the lowest point—the absolute gold point—beyond which sterling would not have declined. This fact is held to dispose of the belief that the anomalous situation that existed for over seven months has removed every limit to a possible depreciation of sterling.

One of the consequences of this unusual situation was that the South African refined bar gold handled in the London market rose to substantial premiums, the extent of which has been determined by the

fluctuations of the French exchange. The French exchange, in turn, was largely influenced by the refining charge, which was first lowered from $1\frac{1}{2}$d. to $\frac{3}{4}$d. per oz., and was then gradually raised to $1\frac{3}{4}$d., only to be reduced again subsequently. So long as there was a strong demand for francs, the Paris rate always tended to be in the close vicinity of its relative gold export point, which again depended upon the refining charge. As there is only one firm of refiners which is in a position to refine gold on a large scale, it was thus placed for a while in a position to determine the sterling-franc exchange rate and the market price cf fine gold. As soon as the insistent demand for francs relaxed, however, the refining charge had to be adjusted to the exchange rate so as to make it worth while for arbitrageurs to ship gold in spite of the rise in the sterling-franc rate.

The exchanges of the countries which followed the French example in refusing to accept bars of standard fineness—especially Belgium and Switzerland—moved in sympathy with the franc, bringing about some moderate shipments of gold from London to those countries. On the other hand, the exchanges of countries which continued to accept bars of a standard fineness—such as the United States, Germany, and Sweden—remained comparatively stable in relation to sterling. Considering that the abnormal appreciation of the franc in relation to sterling resulted in the transfer of funds from London to Paris via other centres, and brought about, therefore, a demand for reichsmark, dollar, and guilder, it is rather puzzling to know why these exchanges did not move against sterling. Failing a better explanation, this phenomenon may be attributed to the work of the psychological factor, *i.e.* the

existence of links of solidarity between the currencies which are on a standard gold basis as against the currencies which are on a fine gold basis.

It was very unfortunate that the highly delicate and difficult international gold situation was further complicated by the Bank of France's attitude to insist upon a minimum fineness of ·995. The Bank of England's decision, to deliver bars of standard fineness only, was dictated by necessity, as a result of the depletion of its stock of fine gold bars. The bulk of its influx consisted of sovereigns; its stock of bars of standard fineness had increased during and after the war through the melting down of sovereigns withdrawn from circulation; while, during the same period, it exported to the United States the greater part of its stock of fine gold. During the twelve months ended May 31, 1930, the Bank sold fine gold amounting to £63,615,000, while the amount of fine gold bought was only £18,334,000; the bulk of its influx consisted of sovereigns. It is necessary to emphasise that, according to the Gold Standard Act of 1925, the Bank of England is only obliged to pay out "gold of the standard fineness prescribed for gold coin by the Coinage Act, 1870", so that there is no reason why that institution should incur expenses by refining its stock of standard bars in order to be able to deliver fine gold. It is for the arbitrageurs to stand the cost of refining if there is a sufficient margin of profits in the shipment to make it worth their while. Had the present situation remained in force for a prolonged period, it would have resulted in the gradual refining of all the existing stock of gold of a fineness inferior to ·995, which includes not merely bars of standard fineness, but also bars of ·900 fineness origin-

ating from the melting down of gold francs, eagles, etc. The process would have been a lengthy one, however, and it would have involved superfluous expense. At the time when efforts were made to reduce uneconomic expenses caused by international gold movements, by means of earmarking operations between central banks and by means of the projected gold clearing system of the Bank for International Settlements, it would have been illogical to incur additional expenses merely in order to raise the fineness of the world's gold stock to the arbitrarily fixed figure of ·995. It would have constituted a retrograde step, calculated to increase the number of those condemning the fetish-worshipping of gold.

So long as that state of affairs existed, there could not but be a feeling of uncertainty in the foreign exchange markets as to the figure of the gold points, which was highly detrimental to the stability of the exchanges. As bars of fineness inferior to ·995 were "demonetised" in several countries they were taken with reluctance also by other countries; for, in cases of emergency, they may not have been able to sell to countries on a fine gold basis. It is thus obvious that the discrimination against bars of inferior fineness caused considerable inconvenience to most central banks, as they possessed a fairly large amount of such bars. It caused inconvenience to the international money market and to the business world in general, as they could not reckon with the figures hitherto known to represent approximately the limits of possible exchange movements; nor did the French holders of sterling balances themselves entirely escape the inconveniences of this regulation, as they had to withdraw their funds at a time when sterling was temporarily

at an abnormal discount in consequence of the refusal of bars of standard fineness by the Bank of France.

Nobody could attempt to put forward any arguments in favour of the general adoption of the use of gold bars of ·995 fineness for securing the note circulation on the ground that they would serve that purpose better than bars of ·916$\frac{2}{3}$ fineness or ·900 fineness. As the fineness of the French coinage has been fixed at ·900, there was no advantage, even from a minting point of view, in insisting upon a minimum fineness of ·995. The explanation put forward by the French authorities in a circular sent to their diplomatic representatives, that the refusal of standard bars has been made necessary by the regulations of the Mint, sounded therefore unconvincing, especially as it was very easy to change these regulations, and even easier to change their interpretation. That is, in fact, what actually happened early in January, 1931, when the French authorities decided to waive their embargo on standard gold, and fixed ·900 as the low limit of the fineness of the bars accepted by the Bank of France. There was no need to pass any legislation whatever to that end, and the facility with which the change was brought about makes it all the more difficult to understand the stubbornness with which the French authorities insisted until January, 1931, upon a minimum fineness of ·995. Although their decision to remove this irksome restriction ought to be appreciated as a gesture indicating their willingness to co-operate in this respect, it ought to be borne in mind that the change was only brought about after a delay of seven months.

Paradoxical as it may sound, the restriction upon the import of gold of standard fineness tended to

stimulate rather than discourage the flow of gold. Many people inclined to believe that the Bank of England benefited by the restriction as it prevented the withdrawal of large consignments of gold on French account. The fact is that, instead of taking a small number of large consignments, French gold importers took a large number of small consignments. While the withdrawal of large amounts within a few days would have resulted in a rise of the discount rate in London, and would have thus stimulated natural tendencies to check the efflux, the slow drain of gold that went on for months until the middle of January, 1931, failed to impress the discount market, and could have continued for a prolonged period without setting corrective influences in motion. Moreover, the depreciation of sterling below its normal gold export point, and the popular belief that in the changed circumstances it had no gold export point at all, and therefore might depreciate considerably, accentuated the withdrawal of French funds from London, and tended to increase the gold efflux. It is obvious, therefore, that the net result of the French embargo on standard gold was an increase and not a decrease of French gold withdrawals from London.

Some quarters were, in fact, inclined to regard the French attitude in this respect as deliberate sabotage aiming at undermining confidence in sterling. Even if we do not accept this extreme view, it is difficult to put forward any valid excuse for the delay of the French authorities in adopting the obvious common-sense solution, the removal of the embargo on standard gold. The fact that it took seven months before co-operation could be established on a purely technical point of this kind was calculated to damp the optimism

of those who believed that the movement of co-operation was making satisfactory progress.

Even if we were to admit that no deliberate action was taken to encourage the import of gold, it is impossible to exonerate the French authorities from the blame of having done nothing to prevent the movement. It is true that, in December, 1930, and January, 1931, the Bank of France supported sterling, but the extent of its support was not sufficient to check the outflow of gold. Moreover, after the removal of its embargo on standard gold, it unloaded the greater part of the sterling it purchased in the course of its action of support; as a result, the efflux of gold continued at a time when it would have otherwise stopped. Some quarters were inclined to take the view that "it would be indeed too much to expect the French authorities to go out of their way to help the Bank of England, considering that they received no help from this side when they were in trouble". This argument is highly unconvincing, however, as we pointed out in a previous chapter. Circumstances from 1924 to 1926 were such as to make it undesirable, even from a French point of view, to stabilise the franc so long as the Budget was not balanced. On the other hand, in 1930, it was to the interest of every country, including France, that the hoarding of gold should cease. It was, therefore, reasonable to expect the French authorities to take steps to prevent the influx, even if by doing so they rendered a service to London.

CHAPTER XI

THE BANK FOR INTERNATIONAL SETTLEMENTS

THE plan for the establishment of the Bank for International Settlements has provided another field for the clash of French and British interests in the fight for financial supremacy. It is the irony of fate that this should be so, considering that the fundamental idea of the Bank was to assist the movement towards financial co-operation between various countries. That at least was the British conception of the plan. It was hoped that, with the aid of the International Bank, it would be easier to find a common basis for various countries to collaborate in an endeavour to maintain international monetary stability and to secure the comparative stability of the world price level. There were, however, signs which seemed to indicate that the French idea was that the new institution should become the means to the furtherance of France's financial supremacy in Europe as an intermediate stage to world supremacy.

This is the reason why French interests were, from the very beginning, rigidly opposed to the idea of establishing the Bank in London, notwithstanding the fact that at the time of the creation of the Bank for International Settlements, London would have been the most suitable centre for the activities of

the Bank as the following considerations may tend to show:

(1) London was still the most important banking centre in the world, with an unparalleled banking organisation to transact international business of the kind that has to be transacted by the International Bank. From that point of view no other centre could be compared with it. We have seen in previous chapters the deficiencies of New York and Paris. Amsterdam, another alternative, possesses an international banking organisation and also an international outlook, but compares unfavourably with London in its resources and in the extent of its activities. Berlin has comparatively little international business. The same is true of Brussels, while, from an international point of view, neither Milan nor any Italian centre deserves consideration. Switzerland transacts a great deal of international business, but divides it among Zurich, Basle, Geneva, and Berne.

(2) London's foreign exchange market was more suitable than that of any other centre for the transaction of the foreign exchange operations of the international bank. We have seen in Chapter IV. that London is easily the best market in dollars, and that is the currency that matters more than any other. London is, moreover, in an almost monopolistic position in Europe as regards Latin American and Eastern currencies, and has the actual monopoly of most of the exchanges of the British Empire. Wherever the Bank is situated, it will have to transact any business in these currencies via London, so that it would have simplified matters to establish the Bank in London itself.

(3) London possesses the only gold market where there are regular supplies of gold in addition to the

reserves of the central bank. Although, at the time of the establishment of the Bank, London was at a slight disadvantage because the margin of her gold stock—above the minimum requirements—was narrower than that of either New York or Paris, this was obviously only a temporary state of affairs. As the Bank was not meant to be established for only a year or a decade, but as a permanent institution, it was the long view that mattered. There is no doubt about it that, in the long run, the Bank of England will be as well in a position to part freely with any amounts of gold, without inconvenience to the market, as any other bank. Moreover, the regular free supplies of gold will also continue to come to London, wherever the Bank is established, since owing to close political, commercial, and financial association with London, and owing to the exceptional transport facilities to this centre, South Africa will always continue to send her surplus gold to the London market, where she can depend on a regular demand.

(4) London's superiority as a bill market is so generally known and admitted that this point needs no further arguments. It is, in fact, the only really good bill market in the world. We have seen in previous chapters how much inferior both Paris and New York are to London, as far as the bill market is concerned, and also that it is unlikely that they will ever equal London in this respect. The Amsterdam bill market is about the best in the Continent, but its turnover cannot be compared with that of London. As for Switzerland, the system of discrimination adopted by the national bank against bills financing foreign trade between two foreign countries makes the development of an active bill market impossible.

(5) London's geographical position may not be as advantageous from the point of view of intercourse with Continental countries as that of some Continental centres—especially Switzerland—but it is certainly more advantageous from the point of view of the intercourse of Europe with other continents in general and with the United States in particular. It would be a mistake to regard the Bank as being destined to remain an essentially European institution. Admittedly European interests predominate—although American and Japanese interests are also well represented—but its authors meant it to develop into a world bank. None of the Continental centres nor New York is in such an advantageous geographical position as London as the clearing-house of the world. Mail routes and cables from East and West converge upon London to a greater extent than upon any other single centre.

In addition, London has a stronger claim than any other centre to house the head offices of the Bank on moral grounds. Having been the financial centre of the world for many generations, she has a justified claim to regard that position, with its privileges and burdens, as her personal property. The establishment of the Bank in a rival centre tends to some extent to weaken London's position, while it does not weaken the position of other centres which cannot lose what they have never possessed. Thus, the centre receiving the Bank gained largely at the expense of London. As no special British interest attached to the establishment of the Bank, there was no reason why Great Britain, of all countries, should sacrifice part of the advantages she possessed for the sake of it. Had the centre been established in London, it would have

merely confirmed the existing state of affairs. As it is established in Switzerland, it gives a present to that country which has no more claim than any other country to receiving such a gift.

The experts of the Young Committee were unable to come to an agreement as to the seat of the Bank. They deferred the decision to a later date; and the question was discussed at the first Hague Conference, but no decision was reached. It seems that, at that time, neither Mr. Snowden nor the British monetary authorities appreciated the true significance of the location of the Bank and did not make adequate efforts to secure the institution for London. This is to be regretted from a British point of view, as, at that moment, it would perhaps have been possible to obtain the agreement of the other Powers to the location of the Bank in London. The organising committee of the Bank, which met at Baden-Baden in October and November, 1929, decided to choose Basle for the seat of the Bank. The belated British claim for its establishment in London met with the determined opposition of the French delegation. It was understood that the French authorities were prepared to jeopardise the Bank scheme and the whole Young Plan rather than agree to the establishment of the Bank in London. Undoubtedly its establishment at Basle is about the next best solution, both from the point of view of the Bank and from a British point of view; in spite of this, it is to be regretted that the British claim was not adequately pressed from the very beginning. Although, at the present moment, the loss of business brought about by the establishment of the Bank in another centre does not appear excessive, it is premature to form a judgment in that respect. No-

body knows into what the International Bank may yet develop. Possibly, within a few years, its importance will greatly increase and with it the loss caused to the London market by the policy of jealousy followed by the French authorities.

The location of the Bank at Basle was a decided set-back for British interests in the fight for international financial supremacy. The French authorities have followed up their victory by strengthening their position in the management of the Bank. According to the Young Plan, the Bank of France was entitled to appoint three directors against the two directors to be appointed by the Bank of England. Moreover, the French authorities have secured for themselves the post of the General Manager. The importance of this post cannot be too greatly stressed. After all, the Board of Directors meets only ten times a year, so that there is an interval of at least four weeks between two meetings. As the statutes are very vague, the management has considerable freedom of action. This appointment met with the persistent opposition of German interests, who realised the disadvantages of the situation, and insisted on the appointment of a neutral to that post. Their opposition was, however, waved aside. On the part of British interests, nothing was done to secure the post. It might have been possible to insist on an Englishman filling the post, in compensation for agreeing that the Bank should not be established in London. This opportunity was also missed, however, and the British authorities were satisfied with the allotment of a few secondary posts to British nationals.

Another move in this supreme game of chess was the decision of the Board of Directors to confine the

activities of the Bank, for the time being, to Europe. This excluded the participation of the British Dominions and of the Latin-American countries which, most probably, would have been favourable to British, rather than French, interests. Moreover, France was well aware that she stood a better chance of attaining hegemony in a European combination than in a world combination. This is, however, against the intention of the authors of the scheme, and it is of great importance that the activities of the Bank should be extended all over the world, even if it is only from the point of view of spreading the risk.

French interests made yet another attempt calculated to complete their victory. At the meeting of the organising committee of the Bank for International Settlements, the French delegation submitted a proposal for the establishment of an international unit of account, called "grammor", equivalent to one gramme of fine gold. They did not suggest that the Bank should issue currency in "grammor" denomination; that would have been, in fact, against the intentions of the Young Plan, which expressly precluded the Bank from becoming a bank of issue. The "grammor" was suggested to be merely a book-keeping unit in which all the accounts of the Bank were to be kept. According to the memorandum submitted by the French delegation, every central bank was to keep a "grammor" account with the Bank, and an international clearing service would have to be organised in terms of "grammor".

There were some very obvious reasons for opposing this scheme. It would merely have complicated the book-keeping of the Bank, as every item which passed through it would have had to be converted into and from "grammor". Against this it was difficult to see

any compensating advantage. Moreover, there was reason to believe that the proposal of the French delegation was the first step in a most ingenious plan aiming at the increase of the international financial importance of France. Though no actual information is available to that effect, it is highly probable that the intention of the French authorities was to adopt the "grammor" as the French monetary unit as soon as it was adopted by the International Bank as its official unit of account. The present monetary unit in France has no traditions, and has no connections whatsoever with any other currency. The re-establishment of the Latin Monetary Union is entirely out of the question. If, however, France were to adopt a unit which appeals by its simplicity, it might be possible to induce a movement of other countries to adopt the same unit; especially if that unit was, at the same time, that of the International Bank. It is possible that the majority of European countries, and even perhaps a number of countries outside Europe, would have agreed to adopt the "grammor" and would have formed thereby a strong link with the French currency. On the other hand, it was entirely out of the question that either Great Britain or the United States would have abandoned their currencies for the sake of the "grammor". The world would have been divided, from the monetary point of view, into one big block of countries grouped around France with a uniform monetary unit, and two smaller groups, namely, the British Commonwealth and the United States, together with countries in the American sphere of influence. The influence of France would have been predominant in the group of countries that adopted the "grammor". It would have secured for France con-

siderable economic as well as political advantages at the expense of Great Britain and the United States.

It is not surprising, therefore, that the French proposal was not received with enthusiasm at the Baden-Baden conference. It met with the almost unanimous opposition of the other delegations and was rejected by a large majority.

PART II

LONDON'S CRISIS

CHAPTER XII

THE SUSPENSION OF THE GOLD STANDARD

WITHIN a few months after the publication of the second edition of this book unforeseen events produced a financial crisis of unprecedented violence. As a result of this crisis Great Britain had to abandon the gold standard on September 21, 1931. Already before the actual suspension of the gold standard London had ceased to play the part of an active international lending centre, as she had to defend herself against the universal run of her foreign depositors. With the suspension of the gold standard London had definitely to abandon for a time the lead in the sphere of international finance. We do not propose to give a full account in this book of the developments that led to this event, as their description would in itself fill a volume. We shall confine ourselves to examining the financial history of the fateful months that preceded the suspension of the gold standard, exclusively from the point of view of its bearing upon London's position as an international banking centre.

In many quarters the suspension of the gold standard was regarded as proof of the fragility of the base upon which London's financial supremacy has been built. In reality, however, the collapse of September,

1931, was the outcome of the coincidence of a series of adverse factors which no centre, however powerfully secured, could have withstood. Mistakes have undoubtedly been committed on the British side. The margin of exportable gold reserve has been kept much too low for a centre which is exposed to heavy withdrawals at short notice. The authorities took it too much for granted that confidence in sterling would be maintained in all circumstances. They did not realise the extent to which the French gold policy had contributed towards undermining confidence in sterling. Throughout 1929 and 1930, as a result of the withdrawal of French balances, sterling has been as often as not in the vicinity of gold export point, and gold has been withdrawn in and out of season in large quantities. In fact, for some time towards the end of 1930 and at the beginning of 1931, on account of circumstances described in Chapter X., sterling depreciated even below its normal gold export point. But for this state of affairs London would have been in a much better position to resist the pressure caused by the Central European crisis in July, 1931.

The widespread knowledge that sterling was at the mercy of the French authorities also largely contributed towards undermining confidence in its stability. According to the experience described in previous chapters, whenever relations between London and Paris became strained, sterling depreciated, and gold was withdrawn for Paris. As relations between the British and French authorities after the Creditanstalt incident in June, 1931, became more strained than ever, it was feared that the same factor would once more operate. Hence the anxiety of many foreign

holders of sterling to be on the safe side by withdrawing their balances.

It is a frequently repeated argument that Great Britain has herself to blame for her monetary crisis. She is accused of having lent excessively to Germany; of having granted long-term loans out of the proceeds of short-term deposits; of having failed to reduce her wages and costs to the world level; of having failed to raise the Bank Rate adequately in defence of sterling; and so on and so forth. The list of the indictments against this country is endless, but we propose to deal only with these four important points.

The amount of short-term credits granted by British banks to Germany was in the vicinity of £60,000,000. As the total of short-term credits to foreign countries must have been about £200 to £250 millions (the Macmillan Report estimates acceptance credits alone at £157 millions, but does not give any particulars as to other types of credits), Germany's share in the total is decidedly excessive. London has undoubtedly placed too many eggs in the same basket. The extent of the mistake was, however, not sufficiently large to justify the belief that it was the main cause of the suspension of the gold standard. After all, the amount of the commitments of American banks was considerably larger, and that of Swiss and Dutch banks was relatively much larger than that of British banks. Had French banks not been warned for political reasons in 1929 to reduce their commitments in Germany, they would have undoubtedly been involved at least in the same proportion as British banks. £60,000,000 may appear an impressive figure, but it is only a negligible fraction of the total resources of British banks, and it disappears in significance compared with the total British

capital invested abroad. But for the circumstances through which most of these investments have become immobilised, the immobilisation of these £60 millions would certainly not have affected London's position to any noteworthy extent. In normal circumstances London could always have fallen back upon her secondary reserve, represented by about 3½ millions of external investments. The circumstances which made it impossible to realise any substantial part of that amount during the summer of 1931 were entirely without precedent, and could not have been foreseen.

The argument that London has re-lent short-term funds in long-term loans is unfounded. It is true that according to the figures of the Macmillan Report the amount of London's foreign short-term liabilities was well in excess of her foreign short-term assets. This does not, however, mean that London banks have granted long-term credits. Everybody acquainted with banking practice in Great Britain must know that London banks are stricter in this respect than the banks of any other country. What actually happened was that a great part of the short-term deposits received from abroad was re-lent in short-term credits to British customers. These credits were by no means frozen, and London banks found no difficulty whatsoever in meeting the sudden withdrawal of foreign deposits. Had the assumption that short-term funds were re-lent in long-term credits been correct, they would have found it impossible to meet the withdrawals, as was the case with the Creditanstalt and with the German banks. Although in certain isolated cases banking houses had to receive support, all joint-stock banks and most banking houses in London were able to repay foreign deposits out of their own resources. This

fact in itself should dispose of the argument which has been freely used for propaganda purposes during the last few months. Exactly the same reproach might be levied at New York banks which lent to Germany funds deposited with them by country banks.

It was also frequently stated that London's eclipse as a financial centre during the summer of 1931 was due to the rigidity of British wages, which handicapped Great Britain in international competition. Undoubtedly in this respect Great Britain has been at a disadvantage as compared with her foreign competitors. Notwithstanding this, it could not be regarded as the cause of the monetary crisis. The only way in which this factor could have affected the stability of sterling was through its effect upon the trade balance. In reality the adverse balance of our visible trade has increased during 1931 to a moderate extent only, and this increase in itself would not have been sufficient to drive Great Britain off the gold standard. It is true that but for the suspension of the gold standard the trade deficit would have tended to grow as a result of the fall of the world price level, which widened the gap between the cost of production in Great Britain and abroad. But in this respect again, the possession of a huge external reserve would have enabled Great Britain to stand the strain for many months but for the unforeseen circumstances which immobilised the external investments.

The British authorities have been subject to a great deal of criticism both at home and abroad for having failed to raise the Bank Rate to a sufficiently high level. It is maintained that the normal weapon for a banking centre to fight adverse tendencies is to raise the Bank Rate sufficiently high to induce foreign

holders of sterling to leave their balances in London. This argument might apply to normal circumstances, when changes in the Bank Rate can go indeed a long way towards bringing about a readjustment of adverse tendencies. It does not in the least apply, however, to the circumstances prevailing during 1931. Those who believe that higher interest rates would have been sufficient to induce foreign holders of sterling to leave their balances in London must be entirely out of touch with realities. They must be unaware of the extent of the panic that seized the world if they believe that the promise of a higher yield would have been sufficient to influence the decision of foreign holders of sterling. Nobody bothers much about yield if he believes his capital is in danger. It would be futile to try to check a run by promising depositors higher interest rates, for the higher the rate promised, the less they would trust the bank. This holds good not only for individual banks, but also for banking centres. It is true that a high Bank Rate can be beneficial to the exchange also by means other than influencing the trend of short-term funds. In the long run it tends to affect the price level, and if it is raised sufficiently high, it forces business firms to liquidate their stocks at a loss, thereby improving the trade balance. During the summer of 1931, however, events kept moving with dramatic rapidity, and there was obviously no time to await the effect of a high Bank Rate upon the price level and upon the trade balance. In any case it would have been futile to attempt to counteract capital movements with the aid of the adjustment of the current trade balance. As is well known, about £200,000,000 of foreign balances were withdrawn within a few months, and to counteract this it would have been necessary to

increase our exports by several hundreds per cent during a period of acute crisis, which was obviously impossible. Moreover, the increase of the Bank Rate to a too high level would have provoked an acute crisis in the home trade, which would have accentuated the wave of distrust.

It is thus obvious that the panic of 1931 was of such a character as to make it impossible for any financial centre to defend itself against it with the normal means at its disposal. The circumstances of the crisis were such as to make the use of abnormal emergency measures also illusory. For this reason it is entirely unjustified to regard the experience of 1931 as a proof of the inefficiency of London as a banking centre. At the same time this experience has taught us a lesson which may be useful in future. No banking centre should rely to a too great extent upon the confidence in the stability of its currency. Confidence is a highly illusive factor which has to be supplemented by more substantial safeguards so as to avoid unpleasant surprises. On the other hand, excessive caution which manifests itself in the keeping of huge liquid reserves is incompatible with the rôle of international banking centre. Banking does not consist in sitting on gold bags, but in re-lending the resources accumulated. If a centre were to rely exclusively upon its liquid resources for the stability of its currency, it would have to maintain a hundred per cent liquidity, by which fact it would cease to play the rôle of a banking centre. Banking involves a certain amount of risk. London was in the past prepared to face that risk. Had she retained possession of her foreign deposits in the form of gold and foreign exchanges instead of re-lending them, she would have been safe against such a crisis as we experienced last

year. But, then, that would not have been banking. It is precisely because London has undertaken to play the part of the world's banker that she got into difficulties last year. She paid a heavy price for the distinction of leadership in international finance.

CHAPTER XIII

LONDON AND THE CRISIS

THE suspension of the gold standard has dealt a severe blow at London's position as a banking centre. It appeared at that time as if the collapse of sterling in September, 1931, might jeopardise London's claim to leadership for at least a generation. Indeed, the immediate effects of the suspension of the gold standard appeared to justify this belief. The pound, which had been a symbol of stability for over two centuries—apart from its temporary lapses during the Napoleonic wars and the Great War of 1914–1918 —became subject to wide fluctuations. As we pointed out in Chapter II., one of the preliminary conditions of an international financial centre is the possession of a stable currency. If the currency of a centre is unstable it becomes a risky undertaking to lend to that centre or to borrow from that centre. International trade carried on in terms of such currency becomes a gamble. It is true that adequate forward exchange facilities tend to some extent to mitigate the risks involved in the fluctuations of exchanges. As, however, the period for which the exchange risk can thus be covered does not usually exceed three months, this device does not provide adequate safeguards for transactions covering longer periods.

In any case, the forward exchange market practically ceased to exist at the time of the suspension of the gold standard. Owing to the adverse conditions that prevailed during the past two years, speculative spirit was at a low ebb. "Safety first" was the favourite device all over the world, and banks preferred to forgo profits rather than take any risk, or even reduce their liquidity. As without speculation there can be no active forward exchange market, facilities for covering the exchange risk ceased to exist exactly at the time when they were needed the most.

In such circumstances those foreign interests which still had sterling balances hastened to liquidate their holdings, while debts in terms of sterling were being repaid as quickly as possible. From the point of view of the resistance of sterling to the adverse trend, the repayment of these credits was a blessing, as it counteracted to a great extent the adverse trend caused by the withdrawal of balances. It also enabled the Bank of England to acquire exchanges for the repayment of its credits contracted abroad for the support of sterling. From the point of view of London's position as an international banking centre, however, the repayment of sterling credits was anything but favourable. It resulted in a considerable decline of the volume of fine bank bills, and before very long the activities of the discount market became confined to dealings in Treasury bills, and in the "frozen" bills of countries which had ceased to pay their short-term debts.

The moral effect of the suspension of the gold standard upon London's position was even more pronounced than its material effect. It is true that this was not the first occasion on which sterling departed from its parity, nor indeed was sterling the only cur-

rency which, in the lifetime of the present generation, underwent a depreciation and was subject to fluctuations. It was, however, the first time that the currency of a leading financial centre had departed from gold in time of peace. Just because confidence in sterling was in the past very high, disappointment was immense all over the world. A large number of central banks and other banks, commercial firms, and investors in every country have suffered heavy losses upon their sterling commitments. In the first moment of their disappointment the natural reaction was that after their experience they would never trust sterling again. The Press across the Channel did not fail to exploit these feelings, and launched a campaign of abuse and criticism against Great Britain for having abandoned the gold standard. In this it received the valuable assistance of a number of doctrinaire economists who, being out of touch with life, did not realise that to suspend the gold standard was the inevitable result of circumstances against which it was impossible to fight. It was pointed out in Paris that it was the duty of Great Britain to maintain the gold standard at all costs, and if there was no means of counteracting the outflow of foreign funds, the British authorities ought to have followed the German example in declaring a moratorium on external short-term debts rather than have suspended the gold standard. Unquestionably this solution would have suited admirably French political, financial, and commercial interests. Although the official balances would have been locked up, their release would have been only a question of time, and the losses of the Bank of France on these balances would have been avoided. In spite of the moratorium on external debts the

stability of sterling would have depended upon French assistance, and this would have secured the influence of France over British foreign policy. The French Government could have effectively prevented the British Government in such circumstances from imposing duties on French exports. From a British point of view, however, the solution of declaring a moratorium instead of suspending the gold standard was neither justifiable nor desirable. In the case of Germany a moratorium was necessary because the German banks would have otherwise been unable to stand the strain of the withdrawals of foreign credits. This was by no means the case with the London banks. Apart from one or two exceptions, they were in a position to meet withdrawals even without official assistance, and therefore there was no justification or necessity for safeguarding them by a moratorium. Such a measure would have been a much more severe blow to the prestige of London as a banking centre than was the suspension of the gold standard. Moreover, it is by no means certain that a moratorium in itself would have been sufficient to save sterling. With sterling at par British exporters would have continued to be at a severe disadvantage against their foreign rivals, and the increase of the adverse trade balance would have eventually compelled the British authorities to suspend the gold standard. But even if, with the aid of a moratorium, and with further French credits purchased at the price of political concessions, the stability of sterling had been successfully maintained, London's position as an international banking centre would have suffered more than it has actually suffered through the suspension of the gold standard. The moratorium would have undermined confidence in

the British banking system, while the stability of sterling would have been regarded as being based on rather uncertain foundations. In the absence of adequate confidence in her currency and her banks, London as an international banking centre would have died a lingering death. As the trade balance would have continued to be adverse, there would have been no resources available for lending abroad, while the foreign capital invested in this country would have been gradually withdrawn. For this reason London stands a better chance of recovering her supremacy if sterling is stabilised at a lower level where it can be maintained without difficulty than if it had been maintained at par.

Notwithstanding the suspension of the gold standard, London has retained the greater part of her international banking activity. Her foreign exchange market has remained very active in spite of the exchange restrictions which were introduced in September and were only removed in March. Her gold market has also retained a good deal of activity. In fact, thanks to the large shipments received from India, it experienced for some time feverish activity. Although efforts were made to divert some of the gold supplies from India and South Africa to other centres such as Paris and Amsterdam, the predominant part of the shipments came, nevertheless, to London, and were dealt with in this market. Nor did the silver market of London suffer from the change. During the short-lived boom in silver that followed the suspension of the gold standard, the London bullion brokers and Eastern banks had the lion's share in the activity.

The section of the London banking centre which withstood the effects of the crisis most remarkably well

was the discount market. It is true that, as we said, the volume of fine bank bills declined to a fraction of its original market. Notwithstanding this, the unique facilities for buying and selling bills provided by this market have remained practically unaffected. Thanks to the unequalled technical organisation of the market, bills continued to be quoted with remarkably narrow margins. It is true that the market had to absorb a considerable amount of frozen bills, and in many cases these bills could only be placed at a higher discount rate. The fact, however, that, notwithstanding their character, large amounts of such bills could be placed at all, speaks for itself as to the facilities of the London market. Throughout the crisis it was always possible to find buyers for the frozen bills, though in some cases the rate was only a shade under the Bank Rate. Dealings in Treasury bills have remained unaffected by the crisis, and as ever since the war their volume was considerably larger than that of bank bills, the change in the discount market was comparatively moderate.

Over and above all, the stability of the British banking system has been unaffected by the crisis. It has, in fact, provided the one fixed point amidst turmoil and chaos. Throughout 1930, 1931, and 1932 there has not been one single British bank failure. While banks failed by the dozen in France, and by the hundred in the United States, there have been no suspensions in London. It is true that in a few cases assistance had to be provided, but even in most of these cases it was not the authorities who saved the banks in question, but the solidarity of the banking community. The banking houses which were affected adversely by the crisis were carried by their own clearing banks, and, very rare exceptions apart, there was no need for the Bank of

England to step in with direct assistance. In any case, the mere fact that it was possible to provide assistance whenever needed conclusively proves the superiority of the British banking system over that of any other country.

The fact that the British joint-stock banks did not consider it necessary to increase their ratio of liquidity speaks for itself. In France and Switzerland and the United States banks have doubled and trebled their liquidity, and to that end they have had to sacrifice the interests of their old customers. In England the cash ratio at the end of 1931 was, if anything, a shade below the corresponding figure for 1930. This shows that British banks and their depositors trust each other. The banks know that it is entirely superfluous for them to make special provisions to meet exceptional withdrawals. The depositors know that their money is perfectly safe with their banks, and no matter what happens there is no need for them to worry about it. When on September 21 the gold standard was suspended, foreigners in London fully expected a run on the banks, instead of which the banking halls were even emptier than usual. While the resources of French and American banks fluctuated rather widely as a result of withdrawals for hoarding, those of British banks remained barely affected by the crisis. But for the withdrawal of foreign deposits, the changes in the balance-sheet items of British banks would have been negligible.

The British banks and the public have stood the severe test remarkably well. This proves the inherent strength and soundness of the banking system, which, after all, is the foundation upon which the international financial centre must be built. In this respect the

experience of 1931 has conclusively proved the superiority of London over her rival centres.

It is true that London has lost much of her prestige as a result of the suspension of the gold standard. During the months that followed the suspension she recovered, however, the greater part of her lost prestige as a result of the successful efforts to prevent inflation, and the heavy sacrifices of British taxpayers to balance the Budget. While in 1931 Great Britain was regarded abroad as a sinking ship, the spectacular recovery that has taken place during the early months of 1932 has made the world realise the inherent strength and vitality of the British nation. The emergency has brought to the surface the very best qualities of the British character. The return of confidence in Great Britain manifested itself during the spring of 1932 in a strong demand for sterling, which for some time became almost embarrassing, and necessitated intervention on the part of the authorities to check an unwanted appreciation of sterling. Within six months after the suspension of the gold standard the credits of £130,000,000 contracted for the defence of sterling have been repaid to the lenders, and the British authorities have succeeded in accumulating a considerable foreign exchange reserve. London has become once more of first importance in the sphere of international finance.

CHAPTER XIV

NEW YORK AND THE CRISIS

When during the third quarter of 1931 it was becoming obvious that London was unable to hold her lead in the fight for financial supremacy, the question which assumed paramount importance was which centre would take its place. It was evident that neither of the smaller Continental centres could come into consideration. The commitments of Holland and Switzerland in Germany were, relatively speaking, much heavier than were those of London, and they had the additional disadvantage of holding large amounts of German deposits which were subject to withdrawal at a moment's notice. As for Sweden, she had to struggle with the increasing difficulties caused by Ivar Kreuger's then known to be gigantic, now known to be fraudulent, operations, and was in any case entirely out of the picture. New York and Paris were, therefore, the only financial centres which could come into consideration as the possible successor of London. Opinions in international banking circles were divided as to which of the two centres stood the better chance of taking London's place.

Until October, 1931, the majority held the view that the odds were in favour of New York. It was realised that the prolonged economic depression had reduced

considerably the formidable strength of the New York market, but notwithstanding this, as the United States was still by far the largest holder of gold, she was considered to be financially stronger than France. The gold stock of the United States attained a new high record of over 5 milliard dollars in September, 1931, which was about twice as large as the French gold reserve. The stability of the dollar was therefore above suspicion. The view was held that as the memory of the depreciation of the franc after the war, and of its devaluation to one-fifth of its original value, were still fresh in mind, such a currency could not possibly be trusted to the same extent as the dollar, which was retained at par throughout the war and post-war currency chaos. People had become accustomed to regard the dollar as the safest currency even before Great Britain abandoned the gold standard. Since the war the dollar has replaced sterling as an international currency to a very great extent. Although no figures are available, it is probable that the amount of international transactions concluded in terms of dollars has been all the time considerably larger than the amount concluded in terms of sterling. A large proportion of credit transactions between London and Germany, for instance, was concluded in dollars. The franc, on the other hand, has played a very subordinate part in international finance and trade until the suspension of the gold standard. Even a large part of the business transactions between France and foreign countries was concluded in terms of sterling or dollars. Notwithstanding the large French gold reserve, and the comparative immunity of France from the crisis, the franc was not trusted to the same extent as the dollar owing to the possibility of a Franco-

German conflict, which, remote as it was, could not be altogether disregarded. In such circumstances it is not surprising that most people considered New York as London's likely successor in the leadership of international banking.

Those acquainted with the situation in New York were aware that she was for the moment anything but keen on embarking upon the expansionist policy involved in the assumption of London's inheritance. Already before the slump American banks had begun to neglect their international business, as they were too much engaged in financing the domestic boom. Since the slump the internal situation was developing from bad to worse, and the banks were too preoccupied with domestic problems to bother much about international business. In fact, most of them considered it necessary to curtail their existing commitments abroad so as to increase their liquidity. Already towards the end of 1930 the calling in of American credits caused difficulties in Brazil and other countries, and an acute crisis was narrowly averted by support from British banks. During the spring of 1931 American banks began to withdraw their credits from Germany and other Central European countries on a large scale. It was, in fact, their withdrawals that initiated the run on German banks which culminated in the crisis of July. On this occasion there could be no question of replacing the credits thus withdrawn; in fact, when the British and other foreign banks realised the persistence of the drain caused by American withdrawals they could not help following their example. Although withdrawals were thus made by every creditor country, the historical fact remains that the run was initiated by American banks. This fact is not

likely to be in their favour after the return of normal conditions.

The developments of July, 1931, resulted in the immobilisation of considerable amounts of American credits to Central Europe. In such circumstances American banks, which were more anxious than ever to increase their liquidity, were not willing to expand their international business. Although they participated in the well-secured credits to the Bank of England with the Bank of France, the moment they were approached for additional credits in excess of the amount of the Bank of England's gold reserve they were unwilling to go further. Nor were they prepared to participate in the salvage of Central Europe to any extent. The depreciation of sterling inflicted fairly considerable losses on a number of American banks, thereby further discouraging them from participating in international business.

In such circumstances it is not at all surprising that American banks were not in the least anxious to take over the acceptance business lost by London as a result of the suspension of the gold standard. Far from benefiting by the shrinkage in the volume of London's acceptances, New York acceptances have shown also a marked decline. The New York discount market has never had the same facilities as the London discount market, and during the autumn of 1931 the shrinkage in the volume of acceptances, and especially in the demand for acceptances by foreign central banks, rendered conditions decidedly uncomfortable. In order to buy or sell comparatively moderate amounts of bills it became necessary to initiate lengthy negotiations in various directions. Notwithstanding the difficulties of London, her discount market has

remained technically much superior to the New York discount market.

During the last few years foreign central banks have become the principal buyers of dollar acceptances. Their buying was encouraged by granting them exemption from local taxation. As a result of their losses on their sterling holdings these central banks decided to repatriate the bulk of their dollar exchange reserves during the last quarter of 1931. In order to be able to do so they had to convert their bill holdings into sight deposits. Thus they ceased to buy any new bills and allowed their holdings to run out. It was only then that the New York acceptance market realised to what great extent it had been dependent upon this particular source of demand. While the London bill market could remain active even in the absence of any foreign demand, the New York bill market became lifeless once its foreign customers departed.

Within a fortnight after the suspension of the gold standard in Great Britain the world had to realise that even the dollar was not above suspicion. In October, 1931, as a result of the repatriation of balances of central banks and other foreign interests, there was a heavy efflux of gold, and in many quarters it was feared that the dollar might not be able to withstand the pressure. Although confidence was restored by the end of October, on several occasions during the following months the flight from the dollar repeated itself to a greater or less strong degree. The withdrawal of French balances kept the dollar persistently in the vicinity of gold export point, while the budgetary situation and inflationary proposals submitted from time to time in Congress repeatedly brought about dollar scares abroad. Even if the fears entertained as

to the prospects of the dollar were unfounded, the mere fact that such waves of distrust arose from time to time proved that confidence in its stability was by no means so implicit as was generally assumed. Even if, as is probable, the dollar survives the present crisis, the fact that for many months it was not considered an absolutely safe currency will undoubtedly be remembered. It will considerably reduce the advantage of New York over London in the rivalry for financial supremacy. It will also be remembered that the stability of the dollar was maintained to a great extent with British assistance. But for the British purchases of dollars, at first for the purpose of repaying the credits of the Bank of England and the Treasury, and afterwards in order to prevent an unwanted rise of sterling, the defence of the dollar against adverse tendencies would have been much more difficult. During the first five months of 1932 the amount of dollars bought by the British authorities must have been somewhere between $400,000,000 and $500,000,000. Without these purchases the United States would have lost an equal amount of gold. Although the amount of free gold available for export was in excess of that figure, such a wholesale efflux of gold in addition to what has actually been taken by central banks and others might have easily provoked a panic.

The weakness of New York lies mainly in the domestic factor. In times of boom and slump, that factor diverts funds from international requirements. The distrustful nature of the American public deprives the American banking system of the stable basis that is necessary to enable a banking centre permanently to fulfil the functions of the world's banker.

The experience of the crisis has proved that even a

financial centre of the immense strength of New York may become vulnerable in certain circumstances. Even if the foreign funds invested in a centre are retained in a liquid form, instead of being re-lent as was the practice in London, the possibility of a crisis through their withdrawal is by no means excluded. The sudden repatriation of foreign funds and the wholesale efflux of gold may produce a strong adverse psychological effect even if the centre is in a position to meet the pressure. It appears that for an international banking centre even a liquidity of 100 per cent is inadequate to safeguard the centre against every possible emergency. This lesson has undoubtedly been understood in the United States. In fact, there is a strong movement in political and financial circles to devise some means of legislation or otherwise to prevent in future the accumulation of bad money represented by elusive foreign balances. Although this financial xenophobia may not outlast the crisis, it seems highly probable that even after the return of normal conditions there will be less enthusiasm in the United States in favour of making New York the world's banking centre than there has been during the last few years. The wholesale default of borrowers in South America and elsewhere, and the scandalous circumstances revealed in the course of the recent Senate inquiry in which the loans were granted, will also tend to discourage New York from resuming her bid for supremacy. It seems highly probable in future that even if the financial interests of New York were to entertain such ambitions, they would find themselves confronted by a strong hostility of politicians and public opinion towards international financing.

What is even more important, it seems to be highly

probable that the United States will not possess any longer the vast resources she had at her disposal for international financial operations. A large proportion of domestic capital has been destroyed by the slump, and it will take many years before it is once more sufficiently reconstructed to meet domestic requirements. As for the surplus available for lending abroad, it is likely to remain considerably smaller than it was before the crisis. In face of the strong protectionist tendencies all over the world, the United States will be no longer in a position to produce the large export surplus. Her invisible exports will suffer a lasting if not permanent decline through the default of a large number of her debtors and through the inevitable cancellation of war debts. It is true that at the same time the invisible imports represented by tourist spendings and immigrants' remittances are likely to remain smaller for many years to come than they were before the crisis. On balance, however, it is safe to assume that if the United States has any surplus at all it will be a mere fraction of the amounts she had at her disposal for lending to foreign countries. In the past the necessity of re-lending this surplus has given rise to the expansion of New York as a financial centre. The natural result of the disappearance or decline of the surplus will be a decline of New York's international banking activities. It has not taken too deep roots in the financial system of the United States, and, in any case, during the next few years banks will find their hands rather full with domestic reconstruction, so that this decline will not be particularly missed.

CHAPTER XV

PARIS AND THE CRISIS

THE previous chapter has shown that New York has failed to take advantage of London's embarrassment for stepping into her place as the world's leading banking centre. Possibly it may be argued that the reason for this was that New York herself was soon overshadowed by the superior strength of Paris. Indeed, those who believed that New York was the stronger of the two centres had to realise in October that they were mistaken. After the suspension of the gold standard in Great Britain, the storm centre of the international financial crisis shifted over to New York, and while until the end of September the bulk of the capital that was withdrawn from London was shifted to New York, from the beginning of October there was a flight of capital from New York almost as violent as the one experienced in London during the previous month. Central banks and other holders of dollar balances began to repatriate their funds on a large scale. The result was an outflow of gold without precedent, and, as we said in the previous chapter, there was evidence of acute distrust developing against the dollar. At the same time the adverse trend of the dollar brought the strength of the franc into strong relief, and a considerable portion of the funds withdrawn from New

York were transferred to Paris. Indeed, from October, 1931, onwards the French franc was regarded abroad as the safest currency, possibly the only safe currency. Indeed, the French gold reserve underwent a rapid increase through the import of gold from the United States and the acquisition of the major part of South African and Indian gold consignments that came to the London market. In spite of its losses on its sterling balances the position of the Bank of France was exceptionally strong, and its reserve ratio increased week by week.

Paris had, therefore, every opportunity to realise her dream of assuming the rôle of the chief international banking centre. We described in previous chapters the efforts made during the last few years to attract acceptance business to the Paris market. After the suspension of the gold standard the leading Paris banks could have acquired first-class acceptance business without any effort. It was brought to their very doors. In spite of this the volume of acceptance credits in Paris showed no increase; in fact, if anything, it has declined since September, 1931. The reason for this lies in the over-cautious attitude of the French banks. Admittedly, conditions during the last quarter of 1931 and first quarter of 1932 were anything but encouraging. In spite of this there were any number of sound and solvent firms left to whom acceptance credits might have been granted safely. Notwithstanding the soundness of the potential borrowers, and the excellent security they were prepared to offer, most of them had to return from Paris empty-handed, as the French banks have adopted the policy of increasing their liquidity at all costs.

Admittedly their distrustful attitude was justified

by the distrustful attitude of their own depositors. In the autumn of 1931 French banks experienced a run without precedent. There was a wholesale withdrawal of deposits from practically every bank, and many of them succumbed to the pressure. There were numerous bank failures, while several banks of first-rate importance had a narrow escape, and were saved or reconstructed through official intervention. Among others, the Banque Nationale de Crédit had to be supported extensively by the French authorities, and had to be completely reconstructed under a different name. While in some cases the distrust of the public was not altogether unjustified, in the case of the leading banks it was entirely without foundation, as they have been managed on extremely cautious and sound lines. Several of the leading French banks are regarded as amongst the best banks in the world, and yet even those particular banks did not remain immune from the wave of distrust of the French public. This fact discloses a weak spot in the French banking system which hopelessly disqualifies Paris from ever playing the rôle of the world's banking centre. The strength of the British banking system lies in the implicit confidence of the depositors in their banks. The London banks know that they are not exposed to embarrassing surprises on the part of their British depositors. For this reason they can engage in international business without running the risk of having to cut down their commitments on account of heavy withdrawals of deposits at a most awkward moment. Neither the French nor the American banks have this same advantage. They have to reckon with the possibility of a run owing to the nervous and suspicious character of their nationals. So long as this short-

coming is not remedied—and it may take generations to overcome it, if it can be overcome at all—neither of the two centres can establish permanent supremacy as a banking centre.

The Paris discount market has not in the least benefited by the elimination of London's competition. On the contrary, as in the case of New York, its facilities have become much worse through the crisis. Even before the crisis the purchase or sale of comparatively moderate amounts of bills in the Paris market was a matter of negotiations, and in the absence of an adequate technical organisation there was a wide discrepancy between the rates quoted for the same type of bills at the same moment. During the last quarter of 1931 conditions in this respect became considerably worse. According to the experience of many bankers, it takes sometimes several days to place bills amounting to a few millions of francs bearing the name of one of the leading banks. The bills are usually taken by the banks on a tacit understanding of reciprocity. If the would-be seller succeeds in persuading one of the leading banks to take a certain amount of the bills accepted by another bank of equal standing, then he may stand a chance to be able to persuade the other bank to take the bills of the first bank. Such negotiations require a good deal of tact and involve considerable loss of time. On several occasions the market is entirely drained of its bill supplies, and would-be buyers are unable to cover their requirements even though they are prepared to pay a rate well above the one quoted as the nominal rate of the day. The efficiency of the Paris discount market leaves, thus, a great deal to be desired.

Nor was the attempt of Paris to capture the lead as

the gold market any more successful. To that end French financial interests, under the auspices of the authorities, elaborated a scheme for the establishment of a gold refinery which would provide at least as adequate facilities as the London refinery. It was arranged that the existing refining facilities should be pooled by a group headed by the Comptoir Lyon-Alemand. As that bank suspended payment, however, the scheme has been abandoned. Similarly the effort to divert the South African and Indian gold consignments from London to Paris was also unsuccessful. Only a very small fraction of the Indian shipments was landed at Marseilles on its way to London and was dealt with in that market. The only kind of gold market which Paris succeeded in establishing was a retail market to serve the requirements of those desirous of hoarding gold. To that end hundreds of firms sprang up in Paris and the provinces. They imported gold coins from New York and London and sold them to the French public at a premium, which rose at one time to about 5 per cent in the more remote provincial districts. They also acquired bar gold either abroad or from the Bank of France, and divided the bars into smaller pieces so as to meet the requirements of those who could not afford to hoard large amounts. This gold market is obviously of a purely local character and is not likely to outlast the crisis.

As for the international loan market of Paris, it was practically non-existent during the crisis. Apart from the credits granted for political purposes by the French authorities, such as credits to Hungary, Yugoslavia, Roumania, etc., and the guaranteed loan to Czechoslovakia, there were no international loan transactions arranged during the crisis. In this respect the position

of Paris was by no means better than that of London, notwithstanding the former's superior strength and liquidity. In both cases issuing activity confined itself to colonial loans. The French authorities took great care that there should be no transaction which might lead to the loss of part of their gold stock. In any case the banks which participated in the political loans that preceded the crisis, such as the Yugoslav Stabilisation Loan, or the Polish Loan, were hopelessly congested with the bonds that the public did not take, and would have been most reluctant to undertake any new business. Nor, indeed, was the French public willing to take up any foreign loans unless they bore the guarantee of the French Government.

Although the stability of the franc was secured by a huge gold reserve and a diminishing but still considerable foreign exchange reserve, confidence in its stability was by no means absolute, especially in France itself. We have seen above that the French public has adopted the habit of hoarding gold on a large scale, and to that end it was even prepared to pay a premium on gold coins and bars. But for the reluctance of the Bank of France to part with gold, and for the moral pressure brought to bear upon anyone who tried to exercise their legal right to convert their notes into bar gold, a substantial portion of the gold reserve would have been withdrawn by the public for hoarding purposes. As is well known, the hoarding of notes in France has assumed unprecedented dimensions. The amount of notes hoarded is estimated at about 30 milliard francs. This fact in itself is sufficient to prove that the franc is much more vulnerable than most people are ready to believe. In the case of an international conflict, holders of these notes would most probably insist upon their right

of conversion into gold, and the Bank of France would be placed before the alternative of either parting with rather more than one-third of its holding or suspending the convertibility of the notes. Similarly, from an international point of view, the franc is much more vulnerable than appears on the surface. The amount of foreign balances held in Paris is considerable; it is believed to be well in excess of the amount of French balances abroad. Should there be a flight from the franc as a result of the international political situation, the withdrawal of these balances, together with the export of French capital, would wipe out the remainder of the Bank of France's foreign exchange reserve and would result in a heavy outflow of gold. This, together with internal hoarding, might easily place the French authorities in a position where they might consider it advisable to suspend the gold standard. Thus, although the franc has so far maintained its stability throughout the crisis, it is by no means above suspicion, a fact which considerably diminishes the advantage gained by Paris over London as a result of the suspension of the gold standard in Great Britain.

CHAPTER XVI

LONDON'S PROSPECTS

THE best way by which to test the utility of an object, person, or institution is to try to do without it or him for a while. The extent to which anything or anybody is missed gives a fair idea of the importance of their existence in the order of things. The application of this test upon London as the world's banking centre has revealed the fact that her technical organisation is indispensable for the international distribution of credit. Before the crisis the view was widely held abroad that London could easily be replaced by another centre. The experience of the period that followed the suspension of the gold standard has shown, however, that no other financial centre can take London's place. The very same quarters in the United States and France which before the crisis were the loudest in claiming that New York or Paris should achieve financial supremacy are now prepared to acknowledge frankly that London cannot be dispensed with. The leading exponents of the claims of New York or Paris for succeeding London as the world's banking centre are now the first to express their desire to see London resuming her traditional functions.

It is, indeed, a foregone conclusion that the re-

establishment of London as the world's banking centre is merely a question of time. The progress that has already been made in the right direction since the beginning of 1932 has exceeded the most optimistic anticipations, and although there is a good deal left to be done before the end can be achieved, there is no reason to anticipate any unsurmountable obstacles to further progress in the right direction.

In Chapter II. we examined the conditions which a banking centre has to fulfil in order to attain international financial supremacy. Let us now examine how far London is likely to fulfil these conditions in the changed situation.

(1) The world banking centre has to possess ample capital resources available for lending abroad. In this respect there is no reason to suppose that London's position will be fundamentally worse than it was before the crisis. It is true that through the default of a number of debtors and the depreciation of various foreign security holdings, the amount of British capital invested abroad has undergone a considerable decline. It runs, nevertheless, into milliards of pounds, and Great Britain still easily heads the list of creditor countries. It is true that for the moment many of these investments are immobilised as a result of the crisis, but this is evidently a temporary state of affairs. With the return of normal conditions most of these investments will become marketable, and it seems probable that we shall witness a process of re-shuffling these investments, which in itself will provide London with ample activity. As for the current surplus, it is reasonable to hope that its present decline is purely temporary. Admittedly, the fall of invisible exports represented by the yield on foreign investments may

prove to be lasting, and the contraction in international trade may affect British earnings from shipping, insurance, and banking. On the other hand, it is conceivable that, as a result of the depreciation of the pound and of the adoption of tariffs, the deficit of our visible trade will be reduced. Thus, if there was a surplus available for lending abroad during the years that preceded the crisis, there is reason to suppose that there will be a similar surplus after the return of normal conditions.

(2) The possession of an adequate banking organisation is another fundamental condition of financial supremacy. In this respect London's superiority is incontestable. We have seen in the previous chapters that the British banking system has withstood the storm much better than the banking system of any other country. Possibly the next few years may witness a movement of amalgamation among those acceptance houses which have been particularly affected by the crisis. This will be, however, a sound process, as in any case London, like other banking centres, is overbanked, and the elimination of a number of units by amalgamation would reduce competition which before the crisis had assumed excessive dimensions. The British banking system as a whole will emerge from the crisis with enhanced prestige. This alone will go a long way towards assuring London's supremacy in the sphere of international finance.

(3) Freedom of the financial market is another of the indispensable conditions of financial supremacy. Admittedly, London has offended against this rule during the crisis by establishing exchange restrictions, while New York and Paris have maintained their freedom. These restrictions were, however, rather

more liberal than those established in any other country. They did not affect foreign-owned balances, the transfer of which has remained free. This is a point which is worth emphasising, as it shows that even amidst a grave crisis the British authorities are anxious to avoid interfering with the right of foreign depositors to withdraw their funds at will. In any case the period of exchange restrictions lasted for less than six months. The Government took the first opportunity to remove them at a time when most other countries were tightening rather than relaxing their exchange regulations. In this respect Great Britain compares favourably with some of the countries which nominally have remained on a gold basis. There is no reason to think that the crisis has brought about a permanent change in London's attitude towards foreign banks and foreign capital desirous of availing themselves of her facilities. Although at present there is a tendency to discriminate against foreign deposits by quoting for them slightly lower rates than for the corresponding type of local deposits, this discrimination against "bad money" is not likely to survive the crisis. Once conditions become anything like normal, London's banks will be once more as anxious as ever to encourage foreign deposits.

(4) In order to maintain international banking activity, a country must possess an investing public willing to acquire and keep foreign securities. In this respect London's advantage over both New York and Paris is likely to remain at least as pronounced as it was before the crisis. The experience of American foreign bond holders has been particularly unfavourable, so that the average American investor will probably be less keen than ever to acquire foreign bonds.

As for France, the one-sided and political nature of issuing activity is likely to continue to discourage the investing public from taking much interest in foreign bonds. Although British holders of foreign bonds have also suffered heavy losses through default and depreciation, their losses have, on the whole, been smaller than those suffered by holders of industrial shares. There is no reason, therefore, to believe that their attitude will be particularly unfavourable towards foreign issues.

(5) The possession of a stable currency is one of the fundamental conditions of financial supremacy. From this point of view the stabilisation of sterling at a lower level will decidedly improve London's position. The stabilisation of sterling at its pre-war parity in 1925 weakened London's position considerably, as it made it difficult to maintain stability at that level. It seems certain that when the Government decides to re-stabilise sterling it will choose a level at which stability can be maintained without difficulty. Confidence in sterling will be greater at this lower level than it was at its pre-war level. It may be argued that the depreciation and devaluation of sterling has reduced London's prestige, and that it may possibly inspire distrust in the stability of the currency. The experience of the franc has shown, however, that the memory of the public is remarkably short. Although the franc was subject to violent fluctuations between 1919 and 1926, and was eventually stabilised at one-fifth of its pre-war value, within two years of the official act of devaluation it began to enjoy greater confidence than sterling, notwithstanding the fact that the latter was raised at great sacrifice to its pre-war value. It is, therefore, not unreasonable to hope that

within a year or two after the legal stabilisation of sterling it will inspire greater confidence than it did before the crisis. In particular, it seems probable that the authorities themselves have learned their lesson, and that in future they will maintain a larger margin *of reserve* than they did in the past as a safeguard for sterling against every contingency.

(6) The possession of a good money market is another fundamental requirement for the supremacy of an international banking centre. We have seen that in this respect London has remained superior to both Paris and New York even through the darkest days of the crisis. It is certain that with the return of normal conditions the facilities provided by the London market will be in no way inferior to those provided before the crisis. It is true that at present a large proportion of the bills represent frozen credits, and cannot be, therefore, regarded as fine bank bills. The elimination of this undesirable type of draft is, however, only a question of time. It seems probable that sooner or later the greater part of the German and other foreign debtors will be once more in a position to meet their liabilities, and the bills which represent advances to them will become once more self-liquidating. As international competition for acceptance business is likely to be less keen in future than it was before the crisis, London is likely to attract once more the bulk of the first-class business available.

(7) Lastly, the possession of a good foreign exchange market is one of the conditions of financial supremacy. We have seen that in this respect London has retained her lead even while sterling was subject to fluctuations. There is no reason to believe that there will be an adverse change in this respect in future. In fact, the

improvement of forward exchange facilities during the last few months has enabled the London foreign exchange market to satisfy the requirements of trade and banking for covering exchange risks for short periods. Thanks to these facilities, London may assume considerable importance as an international banking centre even before the stability of sterling is restored. Even if the suggestion to stabilise the internal value of sterling and allow its value in relation to gold currencies to fluctuate permanently were to be adopted —which is most unlikely—it would not prevent London from recovering her supremacy so long as adequate forward exchange facilities enable her customers to cover the exchange risk. In any case, if such a system were to be adopted London would by no means remain isolated, and it seems certain that the majority of countries would stabilise their exchanges in relation to sterling.

Although amidst the uncertain conditions that prevail all over the world it is extremely risky to prophesy, it seems safe to conclude that London will emerge victorious from the fight for financial supremacy. Temporary defeat has proved to be a blessing in disguise, not merely because through the depreciation of sterling it has created conditions which in the long run are calculated to benefit London's position, but also because rival interests were forced to reveal their own incapacity to take her place. They have realised that the distinction of being the leading financial centre implies heavy responsibilities which they are not willing to face. It is therefore certain that in future they will moderate their ambitions to supplant London, and that they will show greater willingness to co-operate with her.

APPENDIX I

AMSTERDAM AS AN INTERNATIONAL CENTRE

ALTHOUGH this book is primarily concerned with the fight for supremacy which is going on between the three leading financial centres, it is not superfluous to cast a glance upon the minor rivals which have arisen since the war. Amsterdam is easily the most important of these. Her discount market holds the lead among the discount markets of the Continent, in spite of the spectacular development of the Paris discount market since the stabilisation of the franc. Her foreign exchange market is also as good as any on the Continent. In a small way, the Amsterdam market provides very good facilities for foreign loans.

While the development of Paris and New York has received a great deal of publicity, that of the banking centre of Amsterdam has passed almost unnoticed. This is probably because the progress of Amsterdam was gradual, whereas that of Paris and New York was sudden, and because the ambitions of Amsterdam were far more modest than those of Paris and New York. In the case of Amsterdam, the development was an inevitable consequence of the inflow of German and other foreign capital after the war. The handling of these funds provided a certain amount of international banking activity and necessitated the development of a discount market. A large portion of these funds were kept in a liquid form, so as to be ready to be transferred at a moment's notice. Although the facilities for short-term investment were adequate for the normal requirements of Holland, they proved to be inadequate for these abnormal temporary requirements. Amsterdam suffered, consequently, from an acute *embarras de richesse.* For this reason, the Nether-

lands Bank induced commercial banks and private banks to take up and expand acceptance business. The establishment of German banks' "affiliates" has also helped considerably the development of the Amsterdam bill market. A great part of the acceptance business which was done by the London branches of German banks before the war is now done by these "affiliates".

After the plethora of liquid foreign funds dried up there was no longer any need to force the expansion of the discount market. Far from encouraging a further rapid increase, the Netherlands Bank was, in fact, desirous of checking any undue expansion that may become detrimental to stability. It has restricted the volume of bills by exercising extremely strict discrimination against finance bills and other bills of an undesirable kind. Thanks to the disciplined and loyal co-operation of the banks, it has succeeded in establishing an absolute control over the bill market. Every bank of standing, before granting an acceptance credit of any importance, submits the full particulars of the transaction to the Netherlands Bank for preliminary approval. The latter informs the banks whether or not the bills to be drawn on the credits in question would be eligible for rediscount. As in London, so in Amsterdam the great majority of bills are never actually presented for rediscount, so that the reply does not bind the applicant bank in any way. But in spite of this, the preliminary blessing of the Netherlands Bank is essential to make the bills marketable. While in London ineligible bills—such as acceptances of foreign bank branches, for instance—are actively dealt in at rates above the prime rates, in Amsterdam ineligible bills are practically not marketable, and no bank of standing would either accept or discount such bills.

Thus, although the amount of rediscounts of the Netherlands Bank is comparatively small, its moral control over the market leaves nothing to be desired. It is probably owing to this circumstance that the authorities can afford to pursue a policy that is in several ways more liberal than that of other central banks. The acceptances of foreign banks established in Holland are admitted for rediscount on the same terms as those of Dutch banks. It was found desirable to grant this equality

of footing, not merely because the foreign banks assisted in the development of the Amsterdam market, but also because, having admitted them to equal privileges, the authorities are in a better position to control their activities. Owing to their strength, the German banks established in Holland would have probably been able to develop a market for their acceptances, even if they had not been given rediscount facilities; this market would have probably escaped the control of the Netherlands Bank. It is worth noting that, although these acceptances are now eligible for rediscount, the rate they command in the discount market is slightly above prime rate.

Thanks to its control over the market, the Netherlands Bank is in a position to keep bill rates low, to the benefit of domestic trade, without thereby provoking an abnormal increase of foreign acceptance credits which would eventually lead to a rise in discount rates. There is no discrimination against bills financing trade between two foreign countries; so long as they appear to be genuine commercial bills they are admitted. As, however, it is in most cases impossible to ascertain beyond doubt whether or not a bill is genuine, the strict or lenient attitude of the authorities towards the large number of doubtful cases determines to a great extent the volume of bills.

But for the conservative policy of the Netherlands Bank it would have been possible to bring about a considerable expansion of the Amsterdam bill market, for there has always been a keen demand for bills on the part of Dutch banks. There is also some demand on foreign account; the Netherlands Bank often buys bills on account of foreign central banks, and part of the French balances in Amsterdam has assumed the shape of bill holdings. Generally speaking, however, there is no systematic foreign demand for bills as in London, and it may be said that the Amsterdam bill market is local rather than international in character.

It is probably for this reason that the development of the Amsterdam bill market did not arouse any jealousy in London or in New York. On the other hand, the subsequent development of the Paris discount market aroused no jealousy in Holland. Dutch banking circles were well aware that, if the

development of Paris continues at its present pace it would have overshadowed Amsterdam as the leading Continental discount market, but the Amsterdam banker did not begrudge the progress of Paris, even if it was more rapid than that of Amsterdam, so long as the former's expansion did not actually divert business from the latter. Generally speaking, no such diversion of business has in fact occurred. Amsterdam could attract as much business as it was able to carry without overstraining its resources. So long as this is the case, the question whether Amsterdam is first or second on the Continent is considered of little importance in Dutch banking circles.

For similar reasons, the decline of the demand for Dutch acceptance credits for Central European countries, brought about by the recovery of these countries, did not worry banking interests in Amsterdam. In 1924, though monetary stability in Central Europe had been restored, London and New York were reluctant to grant direct credits. Amsterdam acted as intermediary until confidence in progress towards stability had been sufficiently restored to make the establishment of direct links with the two leading centres possible. The Amsterdam bill market did not, however, suffer a setback as a result of the change. If there was a decline in the volume of certain types of acceptance business, it was more than offset by the expansion of other types. Nor did the withdrawal of part of the German, French, and Belgian balances after the stabilisation of their currencies deprive the Amsterdam market of the liquid resources necessary for maintaining a steady demand for bills. Although originally it was the existence of these balances which necessitated the creating of a discount market, meanwhile Dutch banks and business houses recognised the advantages of keeping their liquid reserves in the shape of commercial bills, and their gradually increasing demand has more than counteracted the decline of demand on foreign account. In fact, the authorities are in a way relieved at the reduction of elusive foreign resources to comparatively normal proportions, as it has contributed towards the stability of both bill market and foreign exchange market.

Amsterdam, like every other discount market, has been

affected by the world-wide increase of demand for short-term investments, which, together with the simultaneous decline of demand for acceptance credits by first-class borrowers, has created a rather anomalous position.

The crisis of 1931 affected the Dutch bill market considerably. A great part of the bills have become frozen and activity has declined. There is every reason to believe, however, that, once equilibrium is restored, the Amsterdam discount market will continue its moderate expansion. Dutch banking quarters are well aware of the limitations of their resources, and the sober and practical spirit of the authorities will safeguard the market in future, as in the past, against the disturbing effect of sudden growth followed by sharp reactions. There is a natural desire for expansion, but only because it means additional business, and not for the sake of the somewhat illusory benefit of the enhanced international prestige attached to it.

The Amsterdam foreign exchange market was especially active during the period of speculation in foreign exchanges. In fact, it was regarded as the most speculative of all foreign exchange markets. While exchange restrictions prevailing in Germany, and other considerations, prevented the German banks from taking a very active part in foreign exchange speculation in Berlin, the activities of their subsidiaries in Amsterdam were not fettered. In addition, Amsterdam became the meeting-place of professional speculators in foreign exchanges. As a result her turnover in foreign currencies was quite out of proportion to the resources of the market.

In her issuing activities Amsterdam was very fortunately placed during the period 1924–1928. As a result of the unprecedented prosperity of the Dutch Colonies, the Motherland had ample funds at her disposal for lending abroad. For this reason she could afford to participate in a number of international loans; in fact, hardly any loans were issued, either in London or New York, without the participation of Amsterdam to a small extent. In a way, the investing public of the Netherlands was even more international than the British investing public. While in Great Britain it was impossible to issue a loan in terms of foreign currency, the Dutch investor had no objection

to such loans, which made it easier for international banking groups to come to terms with participating Dutch banks. The fact that a great many foreign dollar loans were introduced into Amsterdam has had rather unfavourable consequences for that centre. During the Wall Street boom, large amounts of these dollar bonds, which were badly placed in the United States, found their way to Amsterdam. While foreign bonds issued in terms of guilders suffered comparatively little during the depreciation of the international bond market in 1928–1930, dollar bonds interchangeable between New York and Amsterdam were entirely at the mercy of tendencies in New York. This state of affairs disclosed the weak point in the Dutch system. It shows that the insistence of the London market that foreign loans quoted there should be expressed in terms of sterling and should not be interchangeable was by no means unreasonable.

Apart from her participation in loans issued in New York and London, Amsterdam also displayed a fair amount of independent issuing activity in conjunction with Switzerland and Sweden. During 1928 and 1929, when the leading markets became increasingly reluctant to issue foreign loans, these three Continental centres, usually under the leadership of Amsterdam, issued a considerable number of small loans.

As a result of the slump in colonial produce in 1929 and 1930, the absorbing capacity of the Amsterdam market has declined to a great extent. Although a revival in the price of colonial produce may bring about a favourable change, it is evident that the limitations of the Amsterdam market are comparatively narrow. It will never develop into a dangerous rival to London or the other leading centres. Nor is this the ambition of the authorities. They are content with the secondary rôle Amsterdam plays in international finance, and are not likely to make any effort to develop into a financial centre of first-rate magnitude.

The financial crisis has affected Amsterdam's position as an international centre in more than one way. An unduly large proportion of the resources of its banks has become frozen, while the existence of large German and other funds which have taken refuge in Amsterdam has rendered the

guilder vulnerable. It is true that, apart from the foreign-controlled Amstelbank and a few local banks, there have been no failures. At the same time the country, together with Switzerland and other smaller countries, has come under a cloud as a result of the Kreuger crisis. It is now realised that a small country is at a disadvantage in times of crisis, as its Government may not be in a position to prevent a huge failure. This consideration is likely to be remembered, and will probably prevent any small country from assuming leadership in the sphere of international finance.

APPENDIX II

SWITZERLAND AS A FINANCIAL CENTRE

In addition to Holland, Switzerland has also made good progress since the war in the field of international finance. Without competing with the three leading financial centres, she has succeeded in establishing herself safely as a financial centre of secondary importance. Curiously, it is a matter of common belief that the Swiss financial market is more international than any other. The origin of this belief is the general international character of the country with its population speaking four different languages; the hospitality with which international institutions are received on Swiss territory; the favourable geographic situation of the country; the great extent to which it has been used as a refuge of foreign funds during and after the war; and the large number of international bankers, arbitrageurs, and foreign exchange dealers of Swiss origin who have established themselves in foreign banking centres. In spite of appearances, however, the Swiss financial market is essentially national in character. In this respect, it is in sharp contrast with Amsterdam, which, if possible, is even more international than London. While in Holland the subsidiaries of foreign banks and foreign finance companies are welcome, in Switzerland they are discouraged by restrictions in law and in practice. While in Holland the issue of foreign loans meets with no opposition, in Switzerland there is a hostile public opinion against foreign loans, which often discourages Swiss banks from making public issues on foreign account. While in the Dutch discount market the authorities do not discourage bills financing trade between two foreign countries—provided they are genuine commercial bills—in Switzerland the

central bank has adopted measures of discrimination against such bills.

We pointed out in Appendix I. that an excessive expansion of the use of guilder acceptances is prevented by the discipline prevailing among Dutch banks, who are willing to submit every transaction to the preliminary approval of the Netherlands Bank. In Switzerland, the same end has been attained by a totally different method. The Swiss National Bank has laid down the rule that only bills financing Swiss trade are eligible for rediscount. As the volume of Swiss import and export trade is not very large, the amount of prime bills that may come to the Swiss market is thereby confined within comparatively narrow limits. The National Bank can thus discourage the flooding of the Swiss market by bills financing trade between two foreign countries. At the same time, it effectively prevents finance bills from benefiting by rediscount facilities. For it is easier to verify the genuine character of a bill that claims to represent the value of goods bought or sold by a Swiss firm than that of a bill financing alleged commercial transactions between two foreign countries. According to the experience of the London market, such bills are, as often as not, finance bills pure and simple. Thus, in addition to keeping the volume of bills down, the restriction adopted by the Swiss National Bank tends to improve their quality.

The policy of discrimination against bills financing trade between foreign countries does not, however, altogether prevent Swiss banks from accepting or acquiring such bills. While in Amsterdam bills that are not eligible are practically unmarketable, in the Swiss discount market there is active dealing in such bills. There is a keen demand for bills not only by the commercial banks, but also by the "Kantonalbanks", which control considerable liquid resources, and, not least, by foreign holders of Swiss balances. The volume of eligible bills is inadequate to satisfy this demand, and ineligible bills are, therefore, easily marketable—at a higher rate than that for prime bills. Those who acquire them usually intend to keep them till maturity; if they change their mind they can always find buyers for the bills, especially as the discrepancy between the rates of

eligible and ineligible bills tends to be smaller for short-dated bills.

Normally, there is a discrepancy of at least one-half per cent between the rates of a three-months' eligible bill and a three-months' ineligible bill. This has the advantage of preventing foreign borrowers from taking advantage of the low money rates prevailing in Switzerland. Thanks to this system, the National Bank was able to maintain a low bank rate throughout the upward trend of international money rates during the Wall Street boom. As a result, Swiss home trade benefited by low rates of interest, while foreign borrowers, so far as they availed themselves of Swiss credits, had to pay a higher rate, and thus contributed towards keeping up banking profits. It appears that the discrepancy tends to be wide when it is important from the point of view of the Swiss home trade that foreign borrowing should not raise domestic money rates, while it tends to be narrow when there are ample resources available for foreign credits—an ideal system from a Swiss point of view, as the Swiss authorities do not attempt to develop a discount market of great international importance. If the decline in the rate for ineligible bills should result in an excessive expansion of the volume of such bills, this need not necessarily affect the rates paid by Swiss trade. All that would happen is that the discrepancy would be widened through a rise in the rate for ineligible bills, and the rate for eligible bills would not necessarily be affected.

There is no rigid rule preventing the National Bank from rediscounting bills financing trade between foreign countries. If its rediscounts decline to too great an extent it may, if it chooses to do so, rediscount such bills. In practice, it has given preference on such occasions to short-dated bills. If, at any time, it wants to increase the international rôle of the Swiss financial market, all it has to do is to relax the self-imposed restriction.

The Swiss financial market is essentially decentralised, owing to the existence of four financial centres of importance, viz., Zurich, which is considered the chief banking centre; Berne, where the headquarters of the National Bank are located;

Basle, whose importance has been greatly increased by the establishment of the Bank for International Settlements; and Geneva, with its French and Italian connections. This decentralisation may be detrimental to the development of an important Stock Exchange, but does not in any way handicap the development of the discount market, loan market, or foreign exchange market. Owing to the proximity of the four centres, and to their excellent telephone connections, their banks can deal with each other almost with the same ease as if they were situated in the same centre. From an international point of view, the decentralisation of the financial market makes no difference, for foreign banks may get in touch with any of the four centres and find no difficulty in receiving a quotation of rates. As the market is active, it is comparatively easy to deal in fairly large amounts. But for the extreme conservatism of the authorities, the Swiss market could develop into a strong rival of Paris, as well as of other centres, without, however, rising to international supremacy.

The Swiss foreign exchange market had a very busy time during the period of wide fluctuations, and has succeeded in obtaining a substantial volume of permanent business. In fact, it may be regarded as the leading Western market in the currencies of smaller central and south-eastern European countries. The issuing activity of the Swiss market is handicapped by the unpopularity of foreign loans and by the frequent campaigns conducted against them. Otherwise Switzerland would play a more important part in this respect.

The establishment of the Bank for International Settlements in Basle has helped considerably in the development of Switzerland as an international financial centre. It has also raised the relative importance of Basle among the Swiss centres. It would be a mistake to believe, however, that the Bank for International Settlements will develop Switzerland into a first-rate financial market. After all, it should be remembered that the greater part of the activities of that Bank is carried out in currencies other than the Swiss franc, and the greater part of its operations are in foreign markets. Undoubtedly, the presence of the International Bank attracts a number of

international companies to Basle; possibly, in the course of time, she may become as important a financial centre as Amsterdam.

Comparatively speaking, the Central European crisis has affected Switzerland to a greater extent than any other country. Swiss banks are involved in Germany to a greater extent than the banks of any other country. Notwithstanding this, there was no serious trouble, thanks to the strength of the Swiss National Bank and to the liquidity of the commercial banks. At the same time, owing to the huge amount of foreign balances, Switzerland has become also extremely vulnerable. She has been also involved in the Kreuger crisis to no slight extent. As in the case of Holland, the distrust against small countries caused by the Kreuger crash, and the inability of the Swedish Government to prevent it, is likely to survive as a permanent handicap to Switzerland in the international competition for financial supremacy. In any case, owing to the limitations of the resources of the country, Switzerland will never become a dangerous rival to London.

APPENDIX III

STOCKHOLM AS A FINANCIAL CENTRE

THE development of Stockholm as a financial centre was largely due to the spectacular international expansion of certain specialised industries in Sweden. As a result, Stockholm assumed a comparatively important rôle. She has participated to a modest extent in a large number of issues, and has even undertaken the issue of loans independently from any other centres.

The Swedish authorities and banking interests did not, however, aim at developing Stockholm into a leading international banking centre. Their ambition was merely to become the banking centre of Scandinavia and Northern Europe. To a very great extent they had already attained this end. The other Scandinavian countries and the Baltic States looked upon Stockholm as their natural financial market, and developed close banking connections with her. But the Swedish banks did not attempt to develop a discount market proper in Stockholm, and this made it clear that they were not aiming at international supremacy. They realised that a market in krona acceptances would necessarily be rather limited, and would not provide adequate facilities either to investors or to borrowers. For this reason Swedish banks did not grant direct acceptance credits to their Swedish and other northern European customers, but arranged acceptance credits for them in London or other centres. As they enjoyed excellent standing abroad, they were in a position to obtain such credits on the basis of the minimum commission charged to first-class banks, and they were thus in a position to secure for their customers cheap credits with reasonable profits to themselves.

The Stockholm foreign exchange market is a local northern European market, rather than an international market. One of the most important branches of its international banking activity was stock arbitrage. In this respect, Stockholm is second to none of the Continental centres, owing to the comparatively large number of Swedish industrial securities which were well introduced in foreign stock exchanges.

The international character of Stockholm after the war was largely the result of the expansion of Kreuger and Toll. The collapse of that group has dealt a heavy blow upon Sweden. Although the Government has succeeded in preventing its repercussions upon Swedish banking and currency, the spirit of expansion of the country has suffered, and its resources have diminished as a result of the losses caused by the crash. Even after the crisis Sweden is likely to keep aloof from international business for a long time to come.

THE END

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